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Bài 1

“FOREIGN DIRECT INVESTMENT, HUMAN CAPITAL AND NONLINEARITIES IN ECONOMIC GROWTH”

Abstract

Bài 1

“ĐẦU TƯ TRỰC TIẾP NƯỚC NGOÀI, NGUỒN NHÂN LỰC VÀ SỰ PHI TUYẾN TRONG QUÁ TRÌNH PHÁT TRIỂN KINH TẾ”

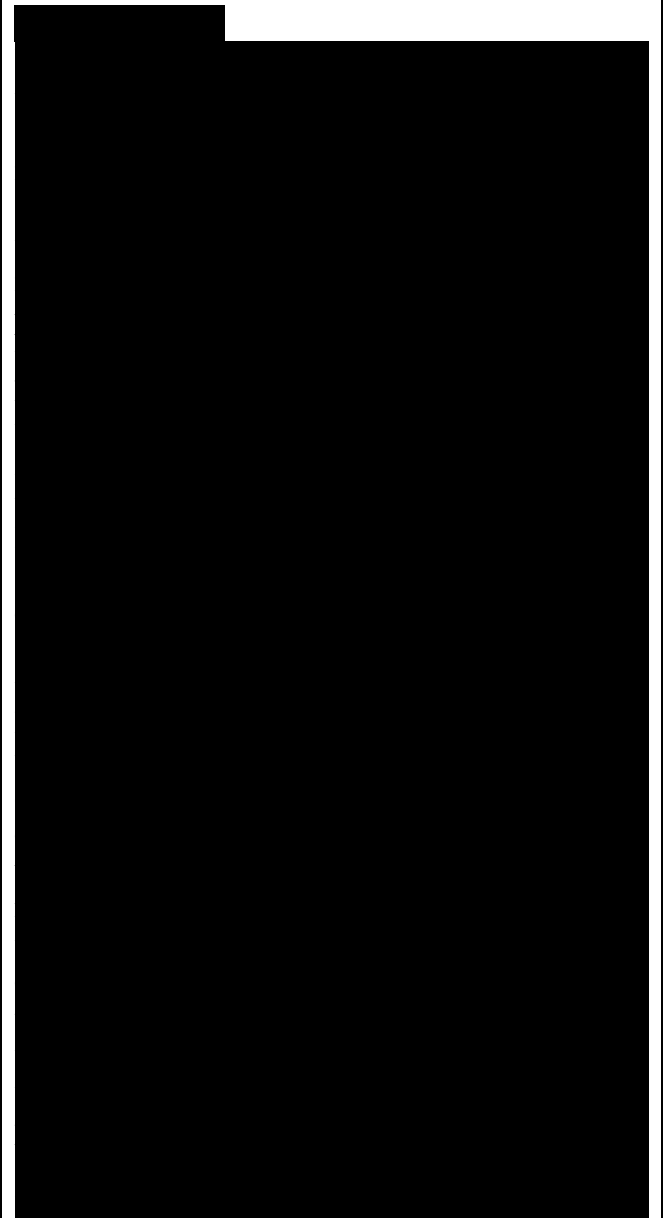
Tóm tắt

This paper examines the effect of FDI on the process of economic growth by allowing the impact to differ both across each country and also across each time period. We apply non-parametric techniques taking into account the previously documented nonlinear effects of initial income and human capital on economic growth. We use a wide range of countries, both developed and developing in order to be able to distinguish potential differential effects between the two groups. Our findings suggest that FDI inflows have a moderately nonlinear effect on growth and that the human capital nonlinear effect in the presence of FDI inflows is similar to the one found elsewhere in the relevant literature.

1. INTRODUCTION

The role of Foreign Direct Investment (FDI) in the growth process has for long raised intense debates. Although this debate has provided rich insights into the relationship between FDI and growth, theory provides contradicting predictions about this relationship. FDI is considered a vehicle through which new ideas, advanced techniques, technology and skills are transferred across borders hence provide substantial spillover effects. In this sense, and within the framework of new growth theories that stress the effect of technological progress on long-run growth rates, FDI may be considered an important factor boosting growth. There is a body of literature that analyses the effect of FDI on growth and another concentrating on knowledge spillovers to domestic firms¹. Empirical evidence seems also contradictory: firm-level studies of particular countries often conclude that FDI is not beneficial to growth and also fail to obtain positive spillover effects to domestic enterprises. On the other hand, country-wide studies examining the effect of FDI inflows in the growth process of countries usually provide positive results, especially in specific environments. The above are particularly of interest for developing and least developed countries (LDC), which basically lack the necessary background in terms of education, infrastructure, economic and political stability in order to be able to innovate and generate new discoveries and designs and in this vein, FDI and

Bài báo này đánh giá tác động của FDI đến quá trình phát triển kinh tế, trong đó chúng tôi tính đến việc những tác động này khác nhau ở từng quốc gia và ở từng giai đoạn. Chúng tôi áp dụng kỹ thuật phi tham số, một kỹ thuật có xét đến các tác động phi tuyến của thu nhập ban đầu và nguồn nhân lực đến sự phát triển kinh tế, những kết quả đã được ghi nhận trước đây. Chúng tôi nghiên cứu trên một loạt các quốc gia, trong đó có cả các nước phát triển và đang phát triển để phân biệt các hiệu ứng đặc trưng của từng nhóm. Nghiên cứu của chúng tôi cho thấy dòng vốn FDI có tác động phi tuyến vừa phải đến sự tăng trưởng, và tác động phi tuyến của nguồn nhân lực khi có dòng vốn FDI phù hợp với các nghiên cứu trước đây.

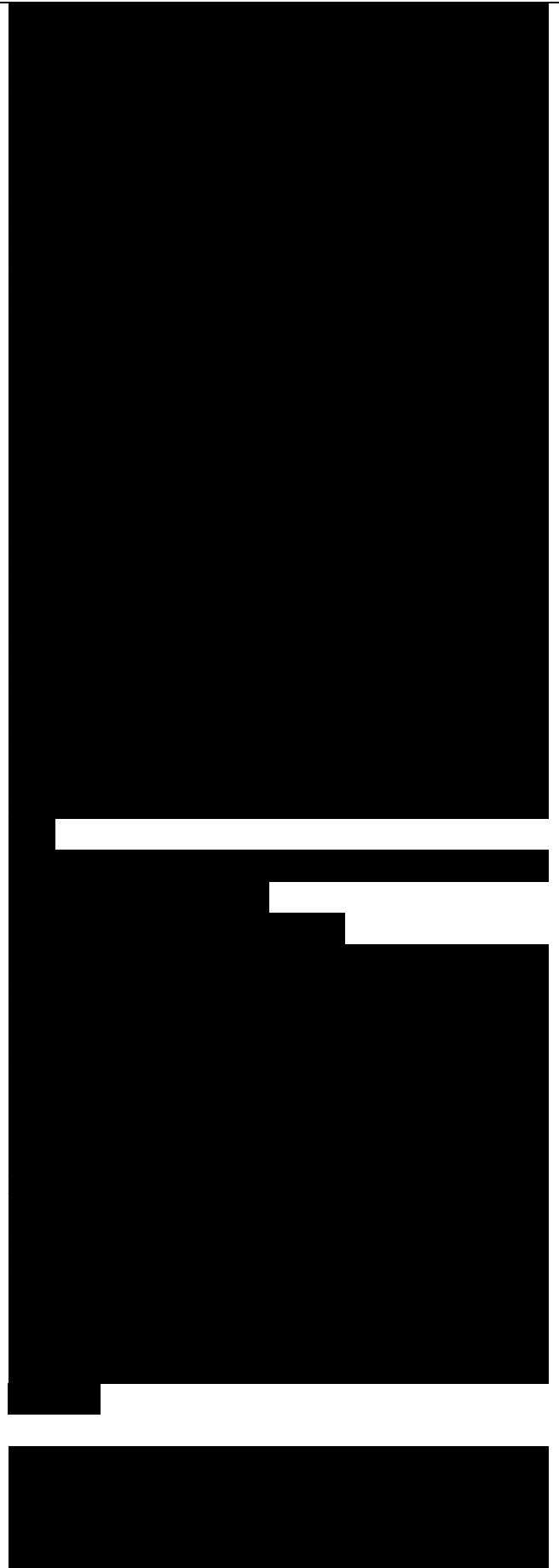


its agents, Multinationals Corporations (MNCs) may conceivably help technological advancement domestically. On the other side of the coin, developing countries and LDCs lack the necessary environment, hence they are not able to reap the benefits associated with FDI and as a consequence they are only used as platforms for MNCs to promote their own benefit by establishing rent-seeking activities.

Moreover, The presence of MNCs may affect domestic firms adversely given the market power of their proprietary assets such as technology, superior brand names and aggressive marketing techniques and as a result, FDI may crowd-out domestic investment. The contribution of this paper is threefold: First, it provides a systematic investigation of the FDI-growth nexus by employing a general econometric framework that allows the effect of FDI on economic growth to differ both intra and inter-temporally by means of recently-developed non-parametric estimation techniques.

Whilst there are a number of studies that bring up the issue of nonlinear effects of FDI on growth, these are imposing specific restrictions as to the nonlinearity on the grounds of human capital, level of development, financial development and degree of openness to trade, by simply incorporating interaction terms in a linear regression framework, or splitting the sample of countries into groups according to the above. Instead, we impose no prior restriction on the potential nonlinearity of FDI on economic growth by resorting to non-parametric techniques, outstripping thus existing criticism on the parametric econometric specification.

Second, we would like to check whether the nonlinear effects of human capital on growth established recently in the literature still holds in the presence of FDI inflows.



Third, while the vast majority of existing related parametric FDI literature stressing nonlinear effects of FDI on growth on the basis of the human capital scale of countries, takes for granted that human capital itself exerts a linear positive impact on economic growth, we drop this assumption and allow for possibly nonlinear human capital effects. Hence, we test for joint effects and interaction of FDI and human capital on economic growth allowing for intra and inter temporal impacts of both on economic growth. We use a wide range of countries, both developed and developing in order to be able to distinguish potential differential effects between the two groups. We reach several conclusions. First, we reestablish that initial income and human capital have a nonlinear effect on economic growth. Second, the relationship between FDI and economic growth is quite complex. The effect of FDI on economic growth differs according to a country's receipts of FDI inflows irrespective of whether they regard developed or developing countries. Third, contrary to the vast majority of previous studies interacting FDI and human capital to jointly assess their impact on economic growth we do not obtain a robust joint effect. Hence our results give support to the two very recent studies that contradict the positive interaction result (Durham, 2004; Carcovic and Levine, 2002). The results may have interesting policy implications. On the one hand, they give credit to policies encouraging rapid expansion of tax incentives, infrastructure subsidies, import duty exceptions and other measures aiming at attracting more FDI as they indicate an overall positive effect. On the other hand, it appears that there are threshold effects of FDI on the output expansion of countries and these thresholds do not rely on their human capital base as this is accounted for by the total mean years of schooling. The nonlinearity appearing in the relationship indicates that FDI affects growth in a different way across countries. Furthermore, this differential impact does not necessarily hold on the basis of the countries' human capital absorptive capacity. Rather, this study suggests that the relationship is much more complex than that since the human capital itself exerts also a nonlinear effect on economic growth.

This may signal the need for a more specialized analysis and policy design within each country since i) FDI may take place in very different sectors/industries among countries on the one hand and on the other hand even if it is in the same sectors/industries it might exhibit different productivities ii) though there appears to be a consensus that it is imperative for a country to have a certain level of absorptive capacity in order to be able to reap the benefits associated with spillover effects, it emerges that this absorptive capacity is likely to depend on a synthesis of necessary economic, financial, political and institutional conditions and not solely on a particular aspect (like the human capital) iii) the evidence is also consistent with Durlauf and Johnson (1995) pointing to a model in which countries pass through distinct phases of development towards a unique steady state. That is, at a given time interval, countries display differences in their growth characteristics in their transition to a high growth position (Galor, 2005) and this is reflected in the observed nonlinearities in the data. As a consequence to the above, policy design with regard to FDI should rather be country-specific based on the peculiar conditions prevailing internally than follow practices implemented elsewhere or rely on general conclusions drawn by research or practice. The paper is organized as follows: the next section discusses the relevant evidence so far with regards to the role of FDI on growth and human capital and growth. Section 3 discusses the methodology and data sources, section 4 then lays out empirical findings and finally section 5 concludes

Bài 2

The Impact of Foreign Direct Investment on Human Development Index in Commonwealth of Independent States

1.1.1 Reasons for FDI

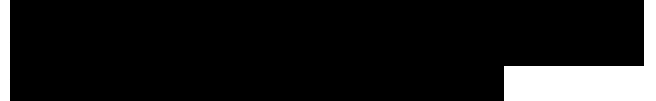
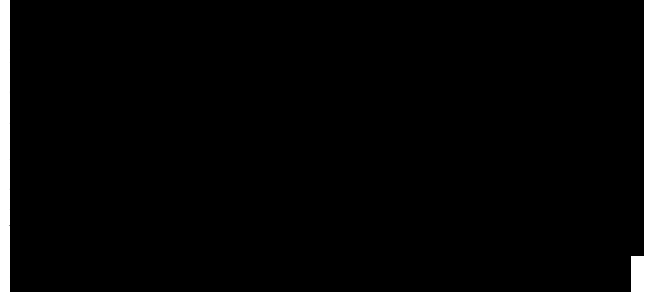
Foreign investors set up new businesses enter in developing countries mainly for the following reasons: they are attracted by the opportunity to reach new markets, get access to required natural resources, to acquire profit from expanding

businesses, favorable market conditions and to lower production costs. Success of the foreign investors that are planning to enter new markets usually depends on being familiar with peoples' cultures, beliefs and values in the chosen for entrance region. Foreign investors should be able to work within the system and adapt to possible changes in it. One of the major investment strategies is to select the right country to direct investments in the potential profitable field. Important aspect here is the ability to see whether planned investment will be attractive for the host-country. According to the Vivek College Commerce paper4, FDI's impact on the recipient country is usually very progressive, because of the inflow of foreign investments:

- Provides financial resources to the developing countries that have limited capital resources;
- Introduce and use new technology, which helps to strengthen efficiency of production, to reduce human working hours and to increase quality of products;
- Increases employment as more new business projects start and more job opportunities for the local population become available. New jobs increase the incomes of the local population;
- Brings the necessary know-hows from overseas specialists, which gives potential to develop new industries in developing recipient-countries, trains and educates local employees. Thus, the level of education and intellectual level may be positively affected;
- Stimulates the achievement of better positions in the highly competitive global market;
- Consumers of the host-country are offered better choice, higher quality of the products, etc.

At the same time, some disadvantages of FDI to host countries may also take place. Expected possible disadvantages of FDI for the recipient country can be:

- Domestic businesses lose their positions when competing with fresh innovative foreign investments;
- Income inequalities within the population may increase;
- New products and services may be expensive for the local consumption;
- As foreign investors monopolize the domestic



market in the host country, products prices may rise and quality may fall;

- Foreign production may substitute the domestic production;
- Foreign investors may influence political or economic decisions of the host countries;
- Sometimes peoples' accustomed life is negatively affected by the environmental changes, which may happen in case of modified or even disappeared territories as a result of new developments, such as building of new plants, exploitation of territory and industrial pollution;

- People are frequently unsatisfied when they feel foreign investors are changing their style of life, change their traditions, religion and introduce new way life, to which people may become skeptical.

1.2 Statement of the Problem

Various studies took place in the past regarding the FDI policies in different regions and their impact on the recipient countries, such as: J.Henisz (2009); S.Sun (2009); M.Tsai (2006); L.Colen, M.Maertens, J.Swinnen (2008); C.Perugini, F.Pompei, M.Signorelli (2005) and many others studied FDI to find out whether FDI has a positive or a negative impact on the economic growth, on the population's life expectancy and other factors important for the country's wellbeing in general. Nevertheless, there is no research that investigates and analyzes the CIS region from this perspective.

All the above mentioned possible advantages and disadvantages are affecting the living standards of population of the host-country. The FDI may improve the HDI in the region. In this research, FDI's impact on four HDI criteria is analyzed.

1.3 Purpose of the Study

The purpose of this study is to discover whether FDI in the CIS countries have a positive or a negative impact on chosen four human development indicators in the region, namely school enrollment, gross national income (GNI), life expectancy and health expenditure⁶. The present work is the first study focusing on the relationship between FDI inflows and their impact on four of the HDI trends in the CIS countries.

1.4 Significance of the Study

By following the developments of HDI in CIS countries, it is possible to assess how FDI affected the life in the region along dimensions measured by the HDI.

It is well known, that countries of the former Soviet Union, members of the present CIS, have all experienced hard transition periods, therefore FDI in this transition could contribute to the countries of the stated region. The main reason for the necessity of attracting FDI is the fact that most of the CIS countries have very good conditions for the incoming investments, such as cheap labor force and cheap resources, but at the same time they have a lack of capital and technology to fuel further economic development. The significance of the present study is to find out whether there is a correlation between FDI and indicators of the HDI and how much foreign investors' activities are affecting HDI indicators, whether these effects are desirable or not. Additionally, this study will give insight to the fellow academicians about the welfare effects of FDI in addition to economic effects of it.

This study will be the first study which attempts to rank and compare indicators between the total amounts of FDI received by the members of CIS and the annual indicators of four human development indicators for the period 1995-2010.

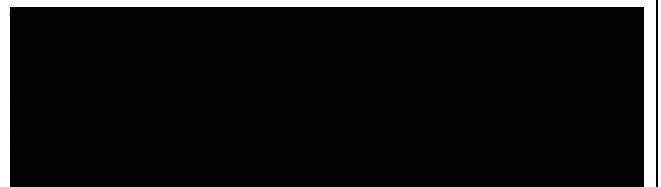
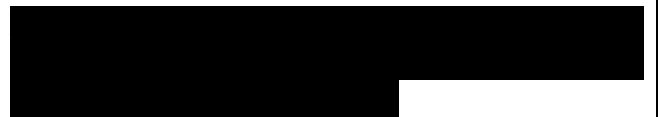
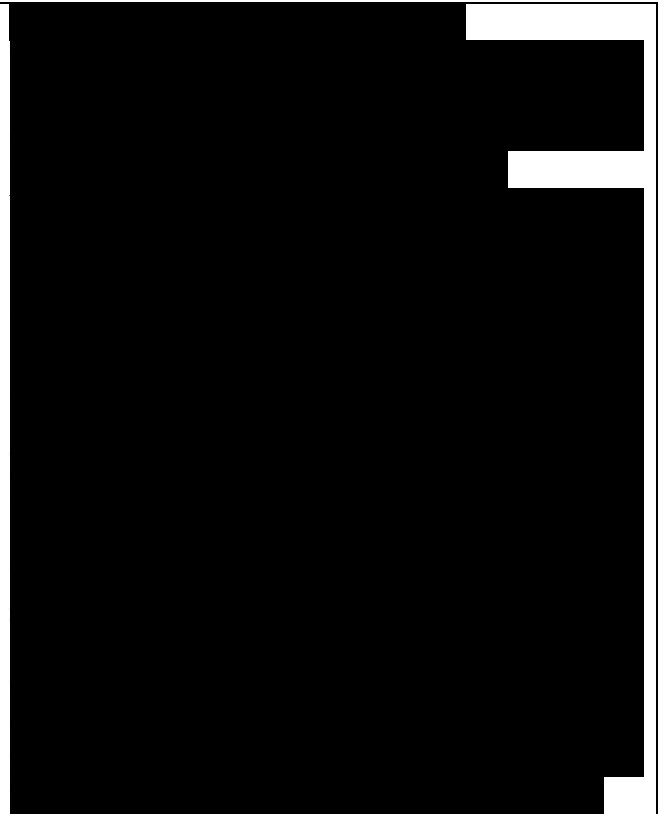
1.5 Methodology

In this thesis, regression analysis is the statistical method, revealing whether one independent variable (FDI) affects four dependent variable (SE, GNI, LE, HE). This study is founded on secondary data analyses.

The primary objective of present study is to survey the relationship between the volume of the FDI inflows into CIS countries and the changes in the four of the HDI.

Another goal of this study is to compare countries that are in the same region in terms of levels of investment conditions and human development indicators.

As noted before, inflows of investments into developing countries from more developed and powerful overseas countries usually bring the wind of huge changes. Whether that wind is positive or negative may be decided only by



comparing the amounts of FDI inflows to the developing countries within the particular period of time and the trend of changes in HDI within the same period.

Statistical data for the present research is collected from annual reports of the World Bank (WB)⁷ for each country in CIS.

Data evaluation, required for the achievement of the further analysis and conclusions, will contain data collected from articles accessible on the websites in internet, books and publications from the library of Eastern Mediterranean University, Organization for Economic Cooperation and Development (OECD) and other possible sources of information.

Simple regression analysis is used to compare the two data sets for different countries. Data sets are gathered from historical time-series statistics of countries. Regression results and graphs reflecting time-trends on each indicator are achieved through the program PASW Statistics, 18

Chapter 2 LITERATURE REVIEW

2.1 FDI's impact on HDI

There is a substantial body of research referring to FDI and HDI separately, focusing on factors affecting each of the indicators in different regions. One of the common research topics is "how does FDI affect HDI?". Sharma and Gani (2004)⁸ examined the effect of FDI on human development, by measuring the human development index scores for middle and low-income countries. They observed that FDI has a positive effect on human development through its economic contribution and infrastructure developments in the recipient countries, with consequent increase in human capital.

Other studies also focus on comparing the relationship between FDI and HDI across different regions. Blomström and Kokko (2001)⁹, for example, found that FDI creates a favorable atmosphere for the development of human capital in East Asia and in Latin America. In both regions local employees' training have improved and their education level increased as a result of FDI and they could utilize more

advanced technology in the production process. Thus in parallel with human development, FDI is observed to support technological progress in the recipient country.

At the same time, there are many studies that observe contradicting results about the benefits and costs of FDI in the host country.

Multinational enterprises (MNEs) have been often criticized due to discriminative and exploitative practices toward local employees and other resources of the host country, as been mentioned in the background document to the OECD-ILO Conference on Corporate Social Responsibility (2008)¹⁰. At the same time, some direct and indirect advantages of the FDI inflows to the host country, such as better pay or improved working conditions, are part of the findings. The study also acknowledges that average salaries in foreign-owned companies are usually higher than in domestic companies. Probably the MNEs try to attract more skilled labor from the host country. Since the financial welfare of the citizens is one of the necessary aspects of human development, it may be considered as a positive factor affecting human development in the host country.

There exists plenty of empirical evidences for globalization's effects on changes in people's life in various countries and regions. For instance, Muhammad et al. (2010)¹¹ conclude that FDI undoubtedly plays a huge role in contributing to the trade, and industrial progress, and economic development in Pakistan.

The multinational firms planning to invest in other countries usually prefer markets with good conditions, developed economies when selecting a location to invest in.

Research by Majeed and Ahmad (2008)¹² argue that higher HDI scores may be one more factor attracting FDI. A positive relation between health expenditures and FDI inflows has been detected by the authors, mainly because work quality of the labor force and ability to learn are dependent on health of the employees. It may be implied that inflows of FDI that positively affect HDI will definitely attract further FDI in particular region.

Subbarao (2008)¹³ has analyzed the effect of FDI inflows on the host country's Human

Development. Subbarao studied FDI inflows from two viewpoints – from the demand perspective and from the supply perspective. Talking about demand, there is a demand and need for better prepared and trained workers who can adopt faster and easier to more innovative technology, which helps to develop employee's efficiency. Supply side means that foreign investors provide jobs and training for employees. Sometimes foreign firms are supporting host country's education system, so the efficiency of the workers can be increased.

Another important aspect concluded by Subbarao is that policies attracting FDI to the host-country should also support further human capital development, it should encourage inventions and educational improvements.

It is important to understand a simple fact in the present topic, that HDI is a cluster of various factors and possibly FDI has a different effect on each of them. Arcelus et al. (2005)¹⁴ analyzed the effect of FDI on life expectancy, educational attainment and wealth and it was found that FDI's impact on different countries vary significantly. Different host countries have different conditions, different situations, thus inflows of foreign investments may show different results, per se it highly depends on the country whether it can convert all the incoming foreign influences into positive changes in human development or not.

Fisher (2003)¹⁵ argues that the big challenge today is poverty reduction and the weapon in the war against poverty is economic growth, which requires correct economic policies supporting integration with the global world. Fisher (2003) states possible implications of the globalization in his work and devotes a substantial part of his work to the discussions of the HDI trends in the post-war period in the developing countries (countries of sub-Saharan Africa, Post-Soviet region, Latin America) where past HDI indicators demonstrated favorable results after the FDI inflows, for instance education level has increased, infant death rates have fallen significantly and democracy improved after liberalizing the economies. Inequality changed significantly as people get more opportunities

and choices. In the research, evidence been revealed by the author that in today's globalized world there is a linkage between more transparent borders of the countries and active international cooperation leading to economic development, affecting the welfare of the population in a positive way.

It is clear that countries have policies to achieve economic targets. Policies may be chosen to pursue economic growth and human development. Depending on that, various results may be achieved with foreign investments or foreign aid. As Kosack and Tobin(2006)¹⁶ point out there is an apparent difference between various policies and if country has chosen a policy focused on achievement of economic growth only (not a human development) by means of attracting more foreign investments or foreign aid, in a small country with poor resources it will only get benefits for few top-level people (elite) and most of the people in the host-country cannot benefit from FDI. Oppositely, when country focus on human development, research shows that FDI and foreign aid leads to economic development.

Naturally, countries needing economic growth may have complex problems, like many barriers against foreign investments. One of the most common problems of all developing countries or countries in transition is corruption and its consequences. Corruption level is considered as a factor playing a key role in human development indicators. When the system is corrupt usually inequalities, injustice, inefficiencies and risks increase, quality of industrial production and education goes down. Thus, corruption undeniably affects human development index. Foreign investors that are ready to solve host-country's problems related to corruption are usually trying to eliminate it at least in the businesses they are working in. Kwok and Tadesse (2006)¹⁷ propose:

“Three avenues through which the MNCs may have an impact on its host institutions: regulatory pressure effect, demonstration effect and professionalization effect.”

Host-countries have no choice, but they have to adapt to the new regulations required by the foreign firms, which is framed by the strict terms and conditions of an agreement. Foreign experts, while introducing an innovative product in the developing country, can demonstrate professionalism and transparent uncorrupted system. Study shows that this definitely reduces corruption and it hugely contributes to the human capital development in the host country.

However, foreign investors may adapt to the local conditions of the host country, adopt the local policies, rules, customs and circumstances

Bài 3

Foreign Direct Investment, Human Capital and Economic Growth in Malaysia

Abstract

The international markets have been the major influence spurring economic growth and development in the Malaysian economy even until today. There were two sources of growth, namely foreign capital and exports of commodities. The government particularly beginning in 1971 moved to develop human capital stock by investing a large amount of public capital in the education sector. However, the growth of human capital did not become a significant catalyst for economic growth. Public and private expenditures for research and development (R&D) remained low compared to neighboring countries such as South Korea and Singapore. This paper examines the effects of Foreign Direct Investment (FDI) and Human Capital (HC) development on economic growth in Malaysia. This paper will also discuss the contribution of these two factors to Malaysia's economic growth for the period of 1980 – 2010 from three angles: Gross Domestic Products (GDP) growth, GDP per capitagrowth and technological change.

4.1 FDI and Economic Growth

In selected literature on economic growth, FDI can boost a country's economic growth and development (Findlay, 1978; Romer, 1993). However, findings from empirical studies on different countries and various levels of

economic progress, methods and periods show that the relationship between FDI and economic growth is uncertain. For example, a number of studies report an insignificant effect of FDI on growth in developing host countries, while other studies find that the effect of FDI on economic growth to be strong in the case of other developing countries, specifically in the Southeast Asian region. On the other hand, studies conducted at the firm level tend to generally show different results from those conducted at the macroeconomic level. Generally there are an ample number of studies showing that FDI inflows lead to higher per capita GDP, higher economic growth rates and higher productivity growth. For instance, Blomström, et al (1994) examined the effect of FDI inflows on the average growth rate of per capita income for a sample of 78 developing and 23 developed countries. The results show the effect of FDI inflows to be significant and positive. Although the effect was statistically insignificant for developing countries with lower per capita income, this was attributed to lower capabilities of those in least developed countries to learn from Multinational Enterprises (MNEs). The reason for this lower capability is that domestic enterprises in the least developed countries are too far behind in their levels of technological expertise and skills to be either imitators of or suppliers to MNEs.

Findings in the majority of studies that look at the relationship between FDI and economic growth suggest that FDI is an important source of capital, that FDI complements domestic investments and is usually associated with new job opportunities and enhancement of technology transfer. This statement is supported by De Gregorio (1992) who analyzed 12 Latin American countries from 1950-1985. De Gregorio found that there is a positive and significant effect of FDI on the economic growth of countries in the study. De Gregorio also found that the productivity of FDI was higher than that of domestic investment. Blomström(1986) showed that the manufacturing sector in Mexico with a higher degree of foreign ownership accelerated productivity growth at a rapid pace. Nair-Reichert and Weinhold(2001) found that there is a causal link between FDI and growth.

Wang (2002) disaggregated the types of FDI inflows to that which would most likely contribute to economic growth significantly in Asia. Wang's study of 12 Asian economies over the period 1987-97 found that only FDI in the manufacturing sector has a significant and positive impact on economic growth and contributed positive spillover effects of FDI to the countries in the study.

Findlay (1978) found that FDI increases technical progress in the host country in the form of offering advanced technologies, styles of management practices and marketing, accounting approaches and other areas related to corporate development of local firms. Similarly, Romer (1993) stressed that FDI can ease the transfer of technology and knowhow to poor countries with possible substantial spillover effects. These two studies suggest the positive contribution of FDI to growth through technological spillover and enhancement. There are several studies showing that the relationship between FDI and economic growth varies under different conditions. For example, Lipsey and Sjöholm (2004) summarize that a specific country and specific factors of industry are very important in determining technology spillover. In other words, Lipsey and Sjöholm studies do not support the overall conclusion that FDI induces substantial spillover effects for the economy. Based on a sample of 15 developed and 17 developing countries for the period 1970-90, De Mello (1990) showed a strong relationship between FDI, capital accumulation, output and productivity growth. However, the study found varying effect of FDI on capital accumulation and the Total Factor of Productivity (TFP) growth across developed and developing countries. The impact of FDI was positive on TFP growth in developed countries but negative in developing countries while the pattern was reversed in the effect upon capital accumulation. De Mello infers from these findings that the extent to which FDI is growth-enhancing depends on the degree of complementarity between FDI and domestic investment, whereby the degree of substitutability between foreign and domestic capital appears to be greater in technologically advanced countries than in developing countries so that the latter may have

difficulty in using and diffusing new technologies of MNEs.

In the case of developing countries, Agosin and Mayer (2000) found that FDI inflows had a crowd-in effect on domestic investments during the period 1970-95. However, in the case of Latin American countries Agosin and Mayer found a crowd-out effect. In the case of African countries, Agosin and Mayer found that FDI had a neutral effect on domestic investments. The empirical findings from Alfaro, et al (2003) suggest that FDI in the primary sector exerts a negative effect on economic growth, while investments in the manufacturing sector exert a positive one with ambiguous effect in the services sector.

Furthermore, a sufficient progress of financial markets development enhances the positive impact of FDI on economic growth (Alfaro, et al., 2003). Balasubramanyam, Salisu, and Sapsford (1996) argue that trade openness is the crucial factor for obtaining positive growth effects of FDI. Based on a sample of 41 developing countries Hien (1992) reported that there was an insignificant effect of FDI inflows on medium term economic growth of per capita income.

Chowdhury and Mavrotas (2005) examined the causal link between FDI and economic growth for Chile, Malaysia and Thailand. For Malaysia and Thailand there was a strong bi-directional causality between the two variables. However, Duasa (2007) indicated that FDI does not directly cause economic growth in Malaysia. Karimi and Yusop (2009) also found that there is no strong evidence of a bi-directional causality and long-run relationship between FDI and economic growth for Malaysia. But Karimi and Yusop stated that FDI has an indirect effect on economic growth in Malaysia specifically through human capital and technology spillover.

4.2 Human Capital and Economic Growth

Modern growth theory maintains that the accumulation of human capital is an important contributor to economic growth. There are

several studies that have explored the effects and relationship of a better-equipped and better-qualified workforce on economic growth.

Generally, findings show that the higher the level of an individual's education, the higher his or her productivity, employment rate and earnings. In this context, education is deemed as an investment that enables individuals to be equipped with knowledge and skills that improve employability and productive capacities that would lead to higher earnings in the future.

In Malaysia, there are a few studies that attempt to explain the impact of human capital on economic growth. Gan and Soon (1996) utilized the Mankiw-Romer-Weil model to derive the implied capital and labor shares in the aggregate value-added for the Malaysian economy. The study found that the average capital share during the period of 1974-94 was 0.4 and this implied labor share was 0.6. Gan and Soon inferred that the rapid pace of the growth output of the Malaysian economy during 1974 to 1994 was driven mainly by capital accumulation, which accounted for 48% of growth. However, the employment growth was about 30%. Economic growth in Malaysia during that period was extensive in form or input-driven. In another study Gan and Soon (1998) argued that with a greater accumulation of human capital along with more efficient financial sector and wider export opportunities, the impact of diminishing returns from capital accumulation can be delayed. Gan and Soon argued in the Malaysian case that human capital and market opportunities affect the productivity of fixed investments and capital accumulation that can ensure that Malaysia could attain a reasonable high rate of growth. The study conducted a regression on the per capital GDP growth for the period 1974-94. In the equation wherein educational attainment (a proxy for human capital or skilled labor) is included, the coefficient of the investment ratio was doubled indicating that the productivity of the educational investment is enhanced substantially by the presence of human capital variables in the equation. Gan and Soon further found that the inclusion of other factors, namely export orientation and financial deepening enhances the coefficient of the

investment ratio even further. Their study concluded that although Malaysia's economic growth is primarily input-driven and despite diminishing returns of capital, it would still take a long time for growth to be substantially slower. The incremental impact on growth from additional physical investment was still substantial. However Gan and Soon stressed that a greater accumulation of human capital and other factors that lead to a larger capital elasticity can make an even longer period of high growth possible before diminishing returns of capital create a slow down to growth.

Gan and Soon (1998) also developed a series of equations to evaluate the sources of trend TFP growth in Malaysia for the period 1974-1994. Their estimation indicated that technological catching-up constituted a substantial component of TFP growth. Gan and Soon also stated that education has contributed substantially to productivity growth. Based on regression results this study showed that a 10% increase in the primary enrollment rate would raise TFP growth by 0.3%, while a similar increase in the upper secondary school enrolment rate would enhance productivity growth by 0.4%. The results also showed that a 10% increase in export ratio raised TFP growth by 0.7% while a 10% decline in the growth of labor force would raise TFP growth by 0.13% suggesting that a more rapid increase in the number of workers entering the workforce will lower the average experience level and make it less urgent for firms to institute productivity enhancing measures. Lucas and Verry(1999) estimated earnings equations using individual data relevant to Peninsular Malaysia in 1988. Their study found a positive relationship between the number of years of schooling and training programmes on the one hand, and higher earnings on the other. Additionally, Lucas and Verry found that higher levels of education are associated with higher productivity. However, their results showed that primary and lower secondary schooling in Malaysia did little to add to the productivity of wageworkers.

4.3 Causal relationship between FDI and Human Capital

There are an ample number of studies to explain the causality between FDI and human capital, as well as the relationship between FDI and human

capital, and economic growth and productivity. In general, most of the studies conclude that there is a link between human capital and education with economic growth. Noorbakhsh, et al (2001), for example, mention that developing countries may attract FDI by pursuing policies that raise the level of local skills and building up human resource capabilities. Their research found that human capital is one of the major determinants of FDI inflow. Saggi (2000) stressed that spillover from FDI requires adequate human capital stock in order for spillover to be feasible.

Dunning (1993) mentions that the determinants of FDI are dynamic and of relative importance that changes over time. Dunning argues that human capital matters are quite significant when FDI is concentrated in higher technology and more knowledge-based activities, while it matters less when FDI is primarily seeking low-cost labor. Pfeffermann and Madarassy (1992) inferred that it is more important to have a pool of well-educated workers and a pool of skilled labor. Having these two pools is advantageous with the rapid advancements of manufacturing technology engaged in knowledge and skills-intensive industries, fulfilling demands of multinational firms involved in high-technology industries.

Tavares and Teixeira (2006) have tested whether human capital is a relevant determinant of FDI in Portugal. Using a large-scale survey of 475 firms located in Portugal, and controlling variables such as a firm's size, age and industry, as well as strategic location for R&D and export intensities and linkages with human capital (collaboration with universities), Tavares and Teixeira found that human capital correlated with FDI attraction positively and significantly. In the case of China, Wei (1995) found that there was a positive correlation between the inflow of FDI and the stock of human capital. Blomström and Kokko (2003) suggested that there is a causality between FDI and human capital, for example, that FDI may promote human capital formation. Dunning (1988) and Slaughter (2002) argued that the level of education and skills of the workforce is bound to influence both the

magnitude and types of FDI inflows in a host economy. Similarly, Zhang and Markusen (1999) suggested that the availability of skilled labor in the host country has a direct effect on the volume of FDI inflows.

In a more recent study, Amitendu and Shoukie (2007) investigated FDI inflows for 14 Asian countries for the period 1994-2003. Their study suggests that Asian countries with well-developed technological capabilities to innovate, develop and effectively apply new technologies through R&D activities have an advantage in attracting FDI compared to other developing economies that do not have these capabilities. Moreover, in the case of India, Amitendu and Shoukie found that the relationship between technological competency and FDI attraction was more apparent between 1991 and 2006. These studies clearly demonstrate the importance of R&D activities in promoting technological capabilities and human capital, which in turn may attract FDI and boost economic growth. Jajri (2007) examined total factor productivity (TFP) and its determining factors in Malaysia for the period 1971–2004. Jajri’s study concluded that the TFP growth for the entire period was not encouraging due to a negative contribution from technical efficiency. He suggested that the Malaysian economy was operating below its maximum potential output level. Jajri also stressed that Malaysia’s high economic growth might not be sustained on a long-run basis.

Hence, the Malaysian economy needs to enhance its productivity-based catching-up capability, by ramping up the effective use of human capital, that is, increasing the number of skilled workers to operate more sophisticated technology, and adopt new technology.

5.0 Endogenous Growth Theory, FDI and Human Capital

The neo-classical theory of growth pioneered by Solow (1956) and Swan (1956), herewith Solow model, states that the accumulation of physical capital is not able to explain the large growth of output per person over time. This is due to geographical differences, differences in income

and levels of technological progress, and the absence of positive economic externalities. The Solow model shows that long-run economic growth cannot rely only on the accumulation of physical capital. An increase in fixed investments without an accompanying expansion in the labor force would only lead to a transitory acceleration of output per capita. Given that an economy's labor force cannot be increased without limit, there is another factor that can produce and sustain the high rate of economic growth. One of the main sources of long-run growth is technological progress. Technological progress here is the "residual" of economic growth that cannot be attributed to growth in capital or labor. This residual is known as "Solow residual" or "Total Factor Productivity".

The residual is related to an increase in know-how or knowledge, discovery of new ideas, or an increase in economic efficiency. However, the Solow growth model does not explain the source of this "technological progress". Thus, this technical progress is often called "unexplained" or "exogenous". In the mid 1980s, a new growth theory suggested by Romer (1986, 1987), Lucas (1988, 1990), and Mankiw, Romer and Weil (1992) treated economic growth rates as endogenous.

The key assumption in this theory is that increasing returns to scale can be made possible by sustaining an increase in investments in both human and physical capital. These investments would create a permanent increase in the economic growth rate of an economy. Endogenous theories of growth emphasize the role of human capital (Lucas, 1990). The differences in productivity among nations are subject to the differences in the skill levels and the abilities of workers to use technology. Another important argument put forth in the theory refers to the effect of technology 'spillovers' on economic growth (Aghion and Howitt 1998; Howitt 2000). The effects of technology 'spillovers' are indirectly associated to the effects of technological change on the economy.

The new economic growth models imply that FDI can affect growth endogenously if

increasing returns in production via externalities and spillover effects are generated.

Therefore, the endogenous theory focuses on externalities arising from human and physical capital accumulation as major forces behind long-term productivity growth. Proponents of this theory view technological progress not as given or a product of non-market forces as quoted in Solow Model but as a product of economic activity. Proponents hold that unlike physical objects, knowledge and technology are not bound by diminishing returns to scale, but instead drive the process of growth.

This is in contrast to the exogenous economic growth model that the impact of FDI on the growth rate of output is constrained by the existence of diminishing returns to the physical capital, in which FDI affects only the level of income and leaves the long-run growth rate unchanged (Solow, 1957; De Mello, 1997). The endogenous growth theory has shown that diminishing returns to capital can be delayed or completely avoided if human capital is added into the production function alongside physical capital and unskilled labor (Soon and Nagaraj, 1998). Barro and Sala-i-Martin (1992) describe that the presence of human capital slows down diminishing returns to physical capital while in the growth model suggested by Rebelo (1991), the production function retains its constant returns to scale while capital is no longer subject to diminishing returns. The adoption and application of advanced technologies spillover mentioned earlier require the accumulation of a substantial amount of human capital in the host economy.

This means that the stock of human capital in the host country acts as a limit to the absorptive capability of that country's economy (Borensztein, et al., 1998). The quality of the labor force is subject to its accumulated experience, and vis-à-vis the education system.

This quality of labor will determine an economy's ability to adapt old technology along with new learning and creation of new ideas. In other words, high quality human capital is a major factor that can absorb technological

spillovers resulting from FDI, and thus is a key determinant of the effects of FDI upon economic growth. FDI is considered as an important source of knowledge and technological diffusion. FDI can contribute significantly to human capital through several possible channels such as introducing new management practices and organizational arrangements, and providing labor training. The impact on R&D could stimulate innovation thereby contributing to the growth of the host country (Grossman and Helpman, 1991; Calvo and Robles, 2003). Therefore, we can safely say that factors such as increasing returns to scale, innovation, trade openness, R&D, and human capital formation are key factors in explaining the growth process.

It is worth mentioning that human capital is an important absorbent of technology brought by MNCs as long as the latter brings a significant contribution to economic growth and as long as indigenous technological development is not established. To be truly competitive requires a complete shift from being recipients of foreign technology to being technology innovators. In our model which is based on the endogenous growth theory, FDI is envisaged to have two effects on economic growth: The first is a direct effect through the increase in capital stock in terms of financing capital formation. FDI contributes to growth directly the same way domestic capital contributes to growth. The second impact is indirect, through the 'spillover' effect. FDI here is assumed to be more productive than domestic investment. FDI promotes growth through enhancing human capital and encouraging new technologies in the host country by diffusing managerial skills, marketing techniques, labor training and skill acquisition, stimulating R&D activities, and promoting exports. Technology and knowledge spillovers will offset the effects of diminishing returns to capital and keep the economy on a long-term growth path. Human capital is assumed to affect growth directly by local workers who learn the technology and new knowledge from MNC firms.

5.1 Empirical Model

The main objective of this paper is to study the contributions of FDI and human capital on

economic growth in Malaysia for the period 1981-2010.

FDI is assumed to contribute to economic growth in two ways: through capital accumulation, and through technology adaptation (spillover effect). Similarly, human capital is understood to be the labor force with tertiary education. Human capital is assumed to contribute to economic growth in two ways: as a quantity of labor employed (or demanded labor as an input in the model), and inequality through higher productivity and technological adaptation. Based on these statements, therefore we assume the following: (a) Capital stock consists of two components, domestic capital (K) and foreign direct investment (FDI); (b) Labor force (L) is disaggregated into two categories- labor force with tertiary education (HC), and unskilled labor (UL). The first category represents the high-knowledge workforce, or human capital (HC). Therefore $L = HC + UL$.

In order to examine the effects of FDI and human capital on economic growth in the case of Malaysia we have constructed three sets of models. The first model estimates the contributions of FDI and human capital on real GDP growth for the period 1980-2010. In this model other variables are included such as domestic capital, unskilled labor (indicated by labor force with lower than tertiary education qualifications), and exports. The variable of exports is included in the model due to the variable associated to FDI substantially in the case of Malaysia. The second model investigates the effects of FDI and human capital on the economy from a different angle that is the effect on the growth of per capita GDP. To estimate the effects of domestic capital, FDI and exports are converted to "per worker" terms. The third model measures the impact of FDI and human

capital on productivity and technology. We assume that the residual from the second model represents the technological progress or productivity herewith as a total factor of productivity-TFP. Then the TFP is regressed with FDI and human capital.

Based on the aforementioned description we developed three model sets. These three models are within the framework of the endogenous growth model. The main production function of this model is the function of stocks, of domestic capital, foreign capital,

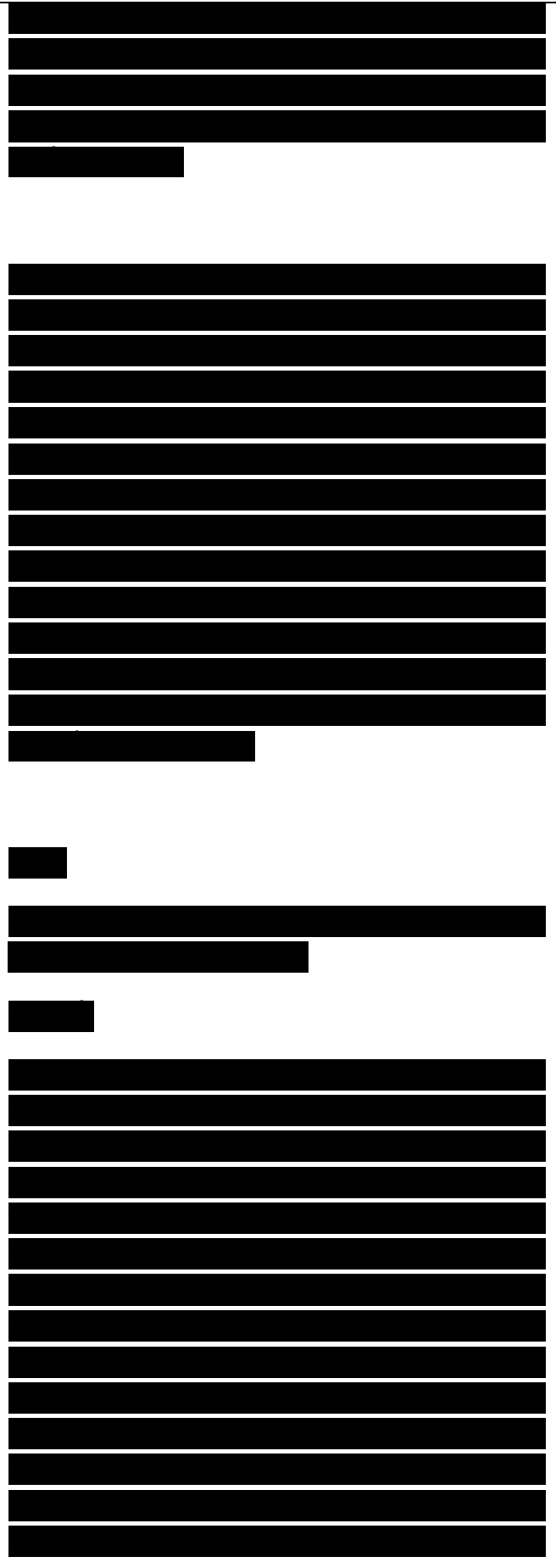
unskilled labor, human capital, productivity and exports. Based on the three sets of models we test the following hypothesis: (1) FDI and human capital positively affect the growth of gross domestic product (GDP); (2) FDI and Human capital positively affect economic growth GDP per capita and; (3) FDI and human capital significantly contribute to technological progress.

Bài 4

FDI, Human Capital, Economic Freedom and Growth in OECD Countries

Abstract

This study investigates the relationship between Foreign Direct Investment (FDI), economic freedom and growth in OECD countries during 1997-2007. Panel data Method is used to estimate two models. The first model is applied to investigate the factors that stimulate FDI and the next one is used to find the growth factors in OECD members. The results of first model indicated that Human Capital, Market Size, Political Stability and Inflation have positive and significant impact on FDI in these set of countries. However, the effect of Economic Freedom on FDI in OECD countries is positive, but it is nonsignificant. As to the next model we found that Foreign Direct Investment, economic



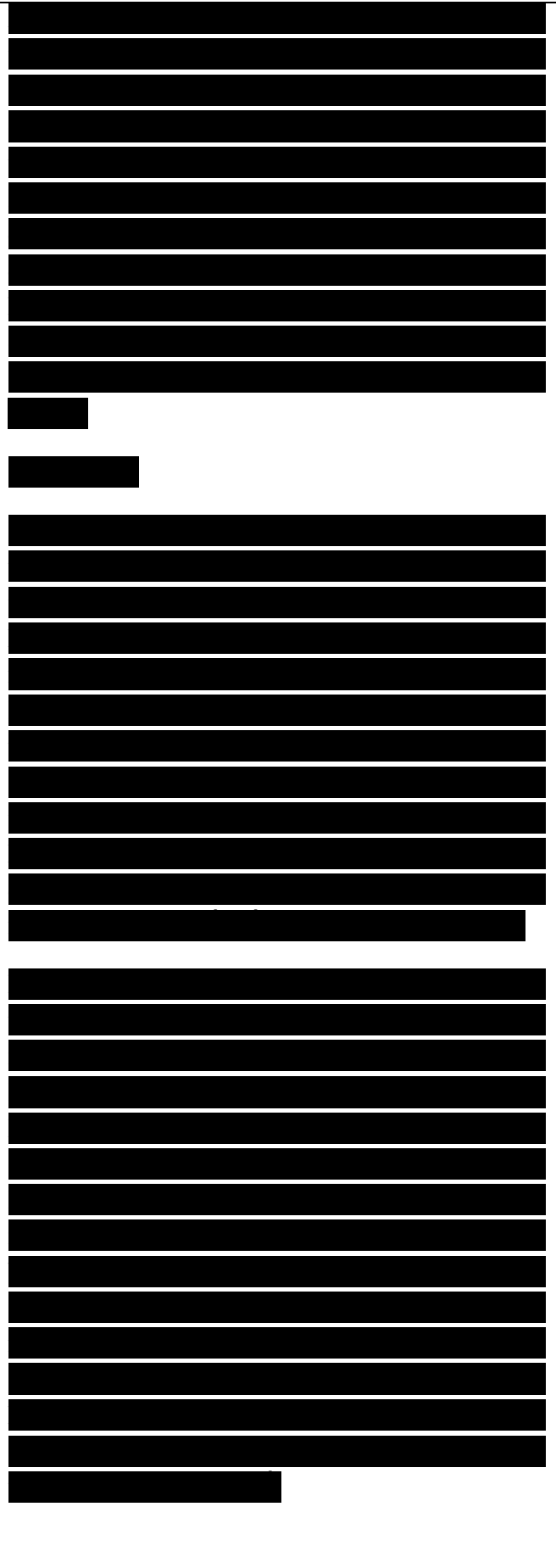
freedom, Government Consumption Expenditure, public investment and Human Capital lead to growth in these countries. However, inflation and external debt have negative effect on growth but this negative effect is not significant for inflation. Thus, policy makers can employ these results in decision making to apply suitable policy that can improve FDI and Growth.

1. Introduction

Solow (1956) represented growth theory and his theory has generated the theoretical basis for growth accounting. Within the framework of the neo-classical models, foreign direct investment (FDI) was not considered seriously as a driving force for economic growth. Since, the impact of FDI on the growth rate of output was constrained by existence of diminishing returns in the physical capital. In contrast, the New Theory of Economic Growth concludes that FDI affects not only the level of output per capita but also its rate of growth.

One important variable that can affect both economic growth and FDI is human capital. In 1960's and 70's the concept of human capital and its role in the economy was investigated by Mincer (1958), Becker (1964), and Denison (1962; 1979). Human capital is a kind of endogenous growththeory, which is a dominant source of economic constant growth and refers to knowledge, education, stock of capability and personality attributes embodied in the ability to perform labor so as to produce economic value. Romer (1986; 1990) found that economic growth is not concerned with a large number of people, but a large amount of human capital can accelerate growth in economic.

Human capital and (FDI) are the key drivers of



growth in developing and developed countries (Bassanini and Scarpetta, 2001). An enhanced human capital, by making the investment climate attractive for the foreign investors, increases the incoming of FDI and this process arises through a direct effect of upgraded skill level of the workforce as well as via indirect effects, such as improved health and socio-political stability. Also, FDI is a key force behind international economic integration and is considered to be an important driver of economic growth in OECD countries, because the internationalization of production helps to better exploit the advantages of enterprises, increase competitive pressures in OECD markets and stimulate innovative activity and technology transfer (OECD, 2005).

FDI is an important element in solving the problem of scarce local capital and low productivity in many developing countries, thus the flow of foreign direct capital is argued to be a potential growth enhancing factor in the receiving country (De Mello, 1999; Eller, et al, 2005). Many policy makers considered that FDI would have important positive effects on a host country's growth and development. It also improves management, technology and labor skills and may increase tax revenues (Todaro and Smith, 2003; Hayami, 2001).

Another factor that has effect on FDI and growth is economic freedom. Bengo and Robles (2003) argued that economic freedom in the developing countries is a positive determinant of FDI inflow and increasing economic freedom is a key priority of policy makers. It also has shown that economy freedom by two channels (indirect and direct) enhance growth in the LDC. Cole (2003) and Gwartney (2009) have shown the countries with greater economic freedom—the protection of private operating markets and of private property

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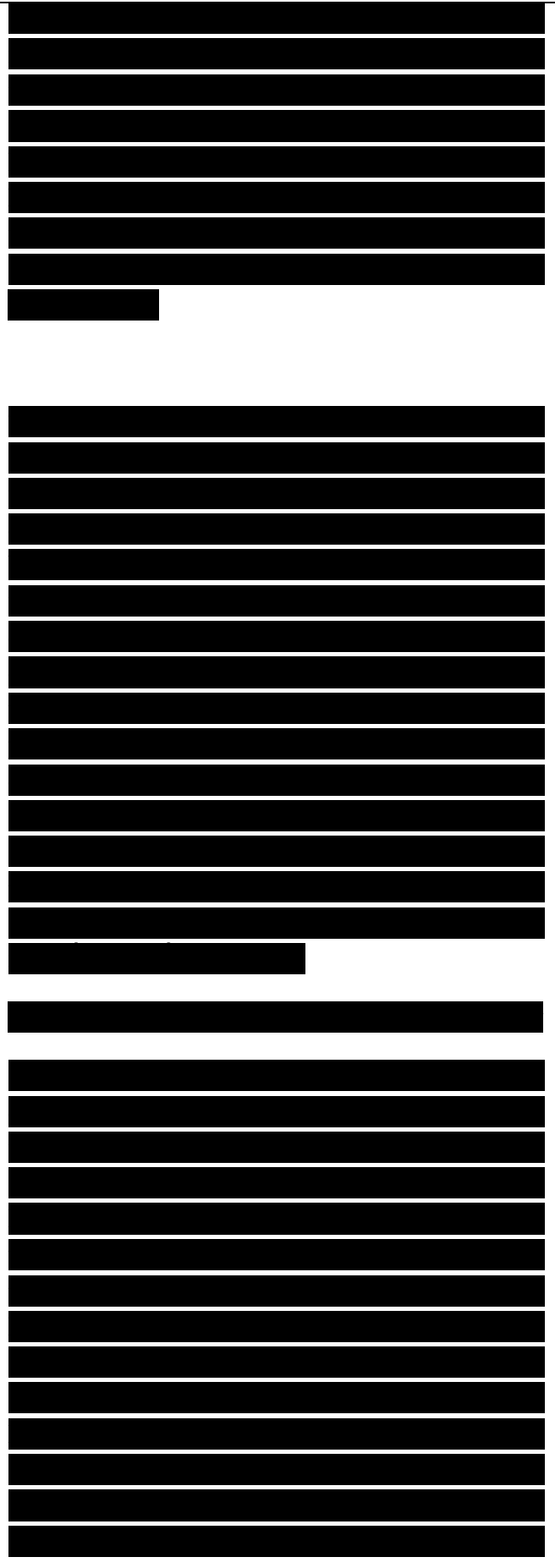
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with minimal government interference- have greater rates of economic growth in comparison to countries with lower levels of economic freedom. Baumol (2002) debated; free economic system of market plays a substantial role as an effective innovative machine behind growth processes in societies where the rule of law prevails.

In this paper we investigate the relationship among these four variables (FDI, Human Capital, Economic Freedom and Growth) and the factors affecting them in OECD countries. The purpose of this paper is to examine empirically the factors that can influence FDI and also the impact of FDI, Human Capital and Economic Freedom on Growth in OECD countries over the period 1997-2007 by using panel data analysis. The structure of this paper is as follows: section 2 provides the literature review about the surveying subject, section 3 discusses material and methods, and section 4 presents the empirical results and their explanation. Finally, section 5 provides the conclusions and policyImplication.

2. Literature Review

There is supporting evidence to this view that FDI has a positive impact on economic growth, and it can foster economic growth in several paths. From the perspective of (De Mello, 1999; De Mello, 1997), FDI via knowledge spillover and capital accumulation may play a major role in economic growth. In this view, FDI will enhance the existing stock of knowledge, through transferring knowledge in the host country and this increase can accelerate economic growth through transferring skills labor training, and transferring new managerial and organizational practice. On the other hand, FDI can, by capital accumulation in host countries, promote the use of advanced technology. Therefore, FDI connected to technological spillovers, can keep the economy

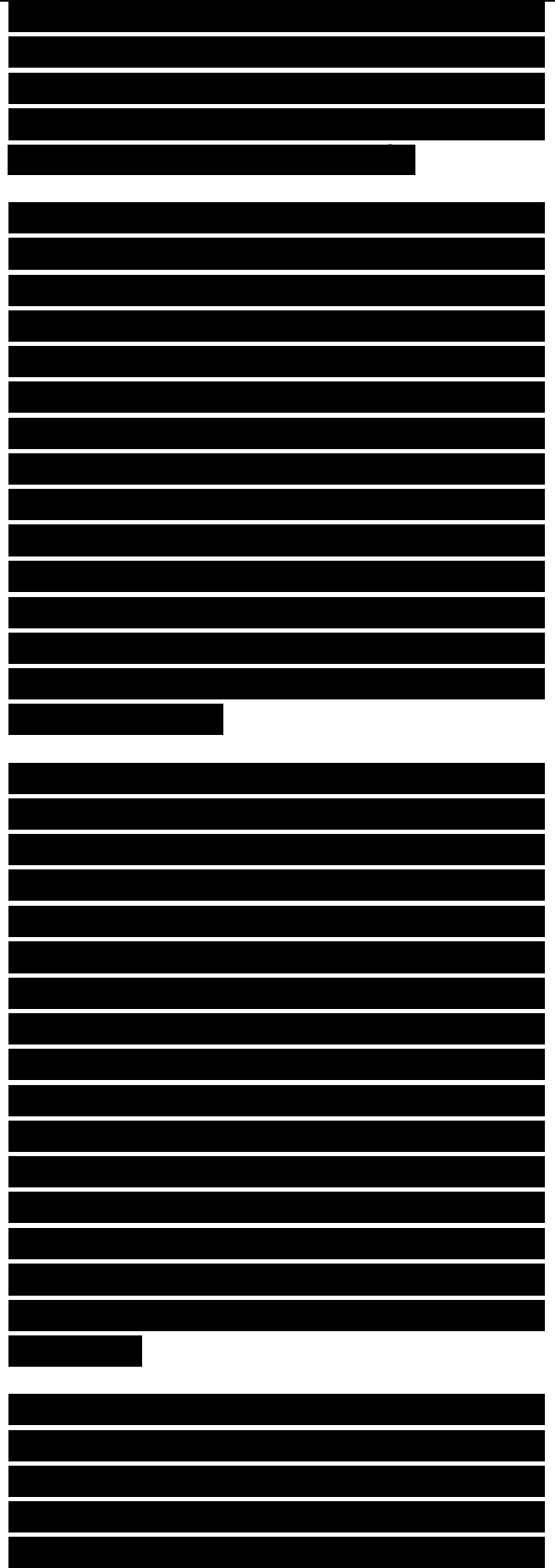


on a long-run growth path by offsets the effects of diminishing returns to capital.

Technologically, FDI is an important instrument for transferring technology more than domestic investment and contributing to economic growth. The rate of technological progress is the most important determinant of the long-term growth rate of income. (Borensztein et al, 1998). Romer (1993) argue that investment gap between poor and rich countries exists and FDI can ease the transfer of technological and business know-how to poorer countries and this transfer may promote the productivity of all firms. According to this assumption, transfer of technology through FDI may have substantial spillover effect for the entire economy.

On the other hand, a number of early studies have usually reported an insignificant effect of FDI on growth in host countries. FDI may have negative effect on the growth rate prospects of the recipient economy if they result in a substantial reverse flows in the form of remittances of profits, and dividends and/or if the multinational corporations (MNCs) obtain substantial or other concessions from the host country. For instance Hein (1992) reported an insignificant effect of FDI inflows on medium term economic growth of per capita income for a sample of 41 developing countries. Bengoa and Sanchez-Robles (2003) debated that in order to benefit from long-term capital inflows; the host country requires adequate liberalized markets, economic stability of human capital and sufficient infrastructure.

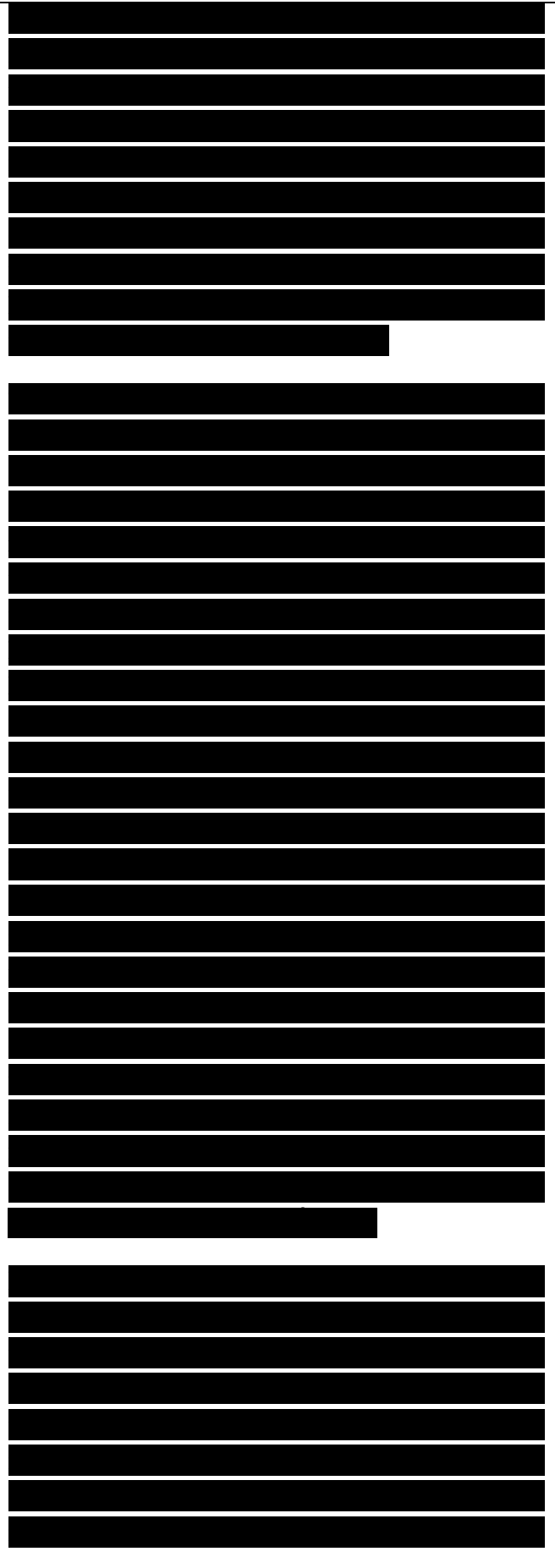
The view that supported by empirical results in De Mello (1999) and Obwona (2001) is that as FDI enhance economic growth in the host country, the host country is able to take advantage of its spillovers. The relationship between economic growth and FDI is debated



for eighteen Latin American countries over the period 1970-1999 by Bengoa et al, (2003). They show that the effect of FDI on economic growth is positive and significant in host countries using panel data model. Also their finding shows that host countries to benefit from long-term capital inflows need adequate human capital, liberalized markets and economic stability.

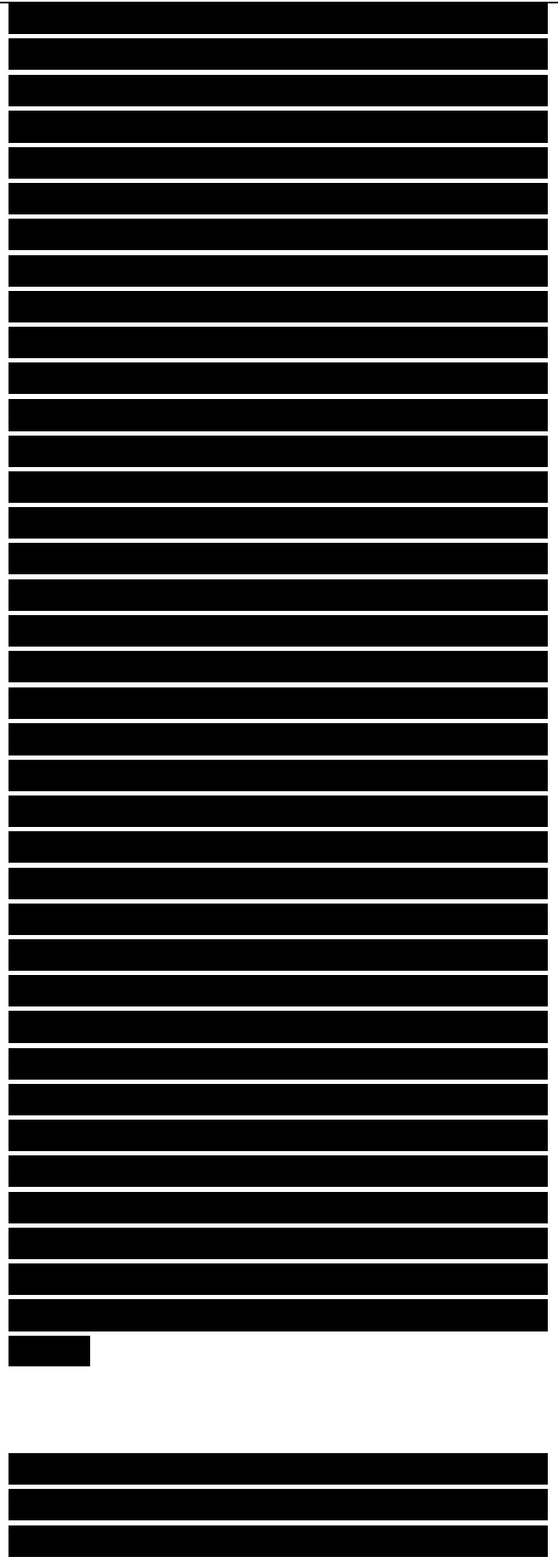
In the research of Li and Liu (2005), based on panel data for 84 countries over the period 1970-1999, they investigate endogenous relationship between FDI and economic growth. They discovered that FDI not only directly enhances economic growth by itself, but also indirectly does so via its interaction terms. Their research concluded that FDI affects economic growth through its interaction with human capital in developing countries, but FDI has negative effect on economic growth via its interaction with the technology gap. While the general technology-absorptive capability is great in developed countries, a larger technology gap would help FDI in generating more profits for economic growth. But the technology-absorptive ability is usually low in developing countries hence a wide technology gap would exert a negative effect on economic growth. Also the level of human capital specifies the ability to adopt foreign technology. Therefore, larger endowments of human capital are supposed to result in higher growth rates, given the amount of FDI.

Human capital and FDI are two aspects of superior relevance to the economic growth and success of any developed nation. Two views exist that explained causality between FDI and human capital. As to Noorbakhsh et al, (2001) views, human capital availability may boost a country's attractiveness as a recipient of FDI projects and another view debated by Slaughter (2002) showed that FDI may promote human capital formation. Human capital has frequently



been recognized as a relevant location advantage. Dunning (1988) surveyed that the level of skills and education of the workforce is bound to influence both the activities undertaken by multinational enterprises (MNEs) and the magnitude of FDI inflow to the host country. For example, human and public capital will determine productivity of the labor force and they are important factors for attracting foreign investor (Obwona, 2001; Bengo and Sanchez-Robles, 2003). Borensztein et al, (1998) and Xu (2000) show that countries should possess a minimum threshold level of human capital to benefit from FDI inflows. Furthermore, a country benefits more from FDI inflows when human capital level of country increases. Narula (1996) estimated the determinants of the FDI stock for both the cases of developed and developing countries and did not find any significant relation between human capital and FDI in developing countries, but in the case of developed countries his result is different. Narula's result shows that, the availability of human capital plays an increasingly relevant role when countries climb the ladder of development until that FDI into developed economies is increasingly aimed at seeking complementary created assets. The effect of human capital including its effect as the source and embodiment of technology innovation, technology shift and technology change and its effect as labor on production, all of these can be motivating factors for economic growth. Two views existed on the effect of human capital on growth. As Islam (1995), showed, the effect of human capital or education on economic growth is insignificant or even negative when the sample under study is restricted to the OECD countries.

Coulombe, Tremblay, and Marchand (2004) debated that maybe One of the reasons for this negative result is related to this fact that of human capital measurement is not straightforward, furthermore human capital is



often measured in an indirect way by using enrolment rates and educational attainments. In contrast when the set of countries are including developed and less developed, standard measures of human capital based on educational attainment appear to have a significant and positive long run effect on countries' gross domestic product and during the convergence process toward the steady state, have transitory positive effect on economic growth (Barro, 2001).

Reaching to threshold level of income can be an important reason for the positive effect of FDI on growth. As to Blomstrom, et al, (1994) survey, threshold level of income above FDI has positive effect on economic growth to above. Countries will suck up new technologies and benefits of technology transfer, and thus reap the extra advantages of FDI if they reach a certain level of income.

This is because it takes a well-educated population (human capital) to understand and extend the benefits of new innovations to the whole economy. From the perspective of Feenstra and Markusen(1994), FDI, through encouraging the incorporation of technologies and new inputs in the production process is expected to increase growth. In the case of new inputs, output growth in FDI-related manufacturing can result from the use of a wider range of intermediate goods.

The Relation between FDI and political stability and political risk was investigated in the number of research in recent years. According to Lucas (1990), literate political risk rather than human capital is the more important factor in explaining capital flows. Using panel data Kim (2010)

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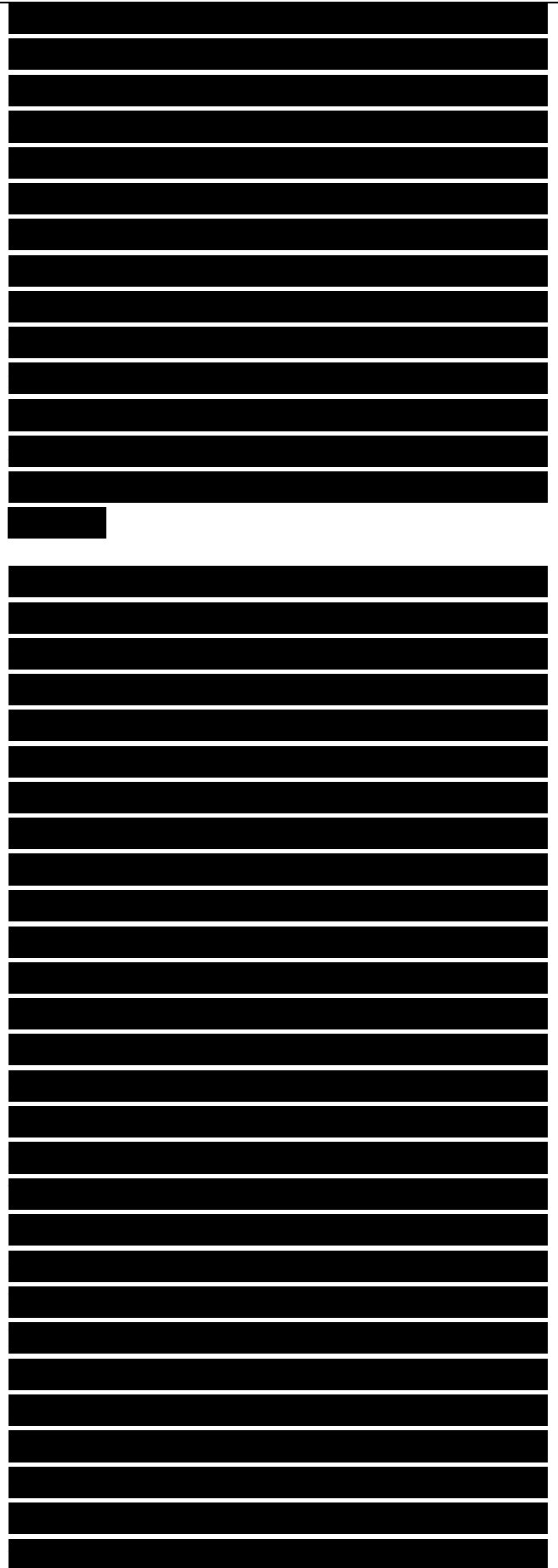
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investigates relationship between the FDI and political stability by investigating the country-level FDI flows, FDI inward performance and political stability measures. Their result showed that the countries with high level of corruption of government and low level of democracy have higher FDI inflows and this result shows that politically unstable countries attracts capital flows from developed countries with high political stability. Also the countries with high political rights have higher FDI outflows and their result is consistent with Lucas (1990), as politically stable countries produce capital flows to invest in politically unstable countries. As to the Singh and Jun (1995) view, for countries that have historically attracted high FDI ,political risk and business operating conditions have been important determinants of FDI and for countries with relatively low FDI, a key determinant was the degree of sociopolitical instability.

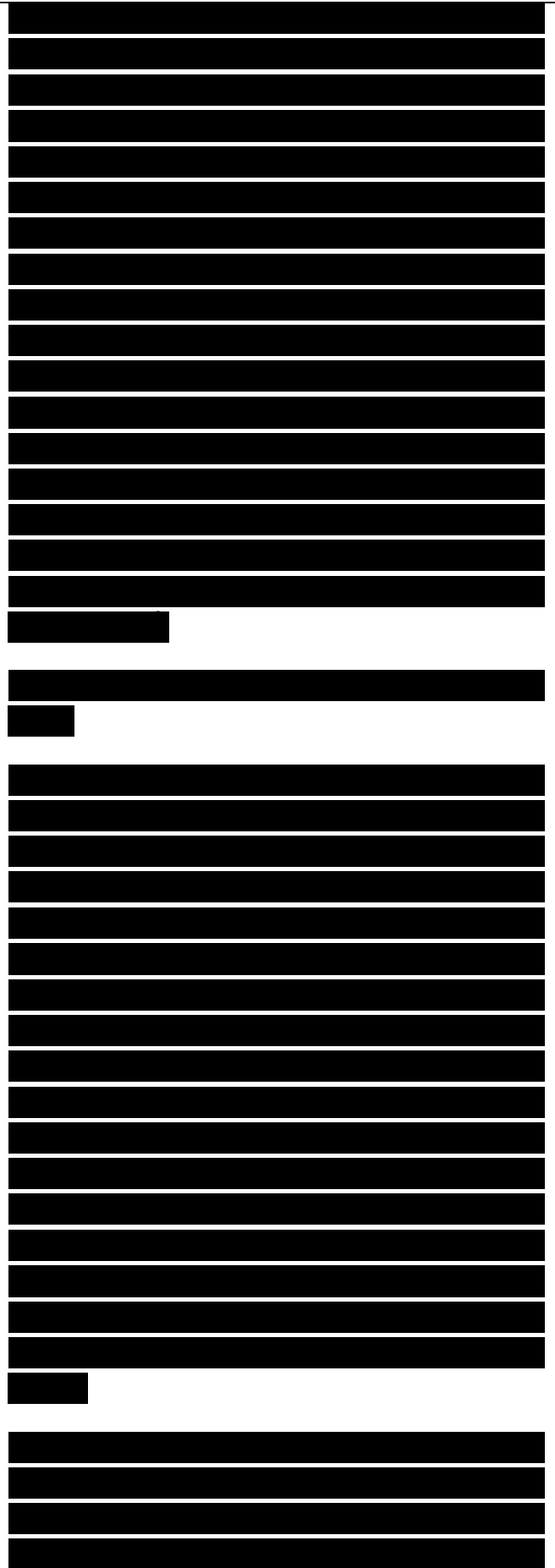
Political stability is the most important attribute of a modern state. The rule of law, degree of democracy or autocracy and economic aspects are the main indicator of political stability (Beetham, 1991; Goldsmith, 1987). As Beetham showed, the biggest changes in the relationship between society and legitimacy are shift in the social or political order. Strong democracies or strong autocracies are best equipped to endure this shift, and hence provide political stability. In terms of economic, when investor and people are assured of the future, they are encouraged to invest and trade and few things seem more likely to undermine business and consumer confidence than the prospect of political unrest and sudden changes in the economic “rules of the game” (Goldsmith, 1987). Stable macroeconomic and political situation with credibility of policy reforms are fundamental factors for foreign investor in the host countries. A stable and sustainable macroeconomic environment boosts the trust of private investors. Decreasing debt burden is not only for sustaining both external



and fiscal balance, but also for engendering confidence to encourage private sector investment. Market size, market growth, human capital, etc. are other important factors that determine the location decision of investors. For instance, Barro (1996) looked at the roles of democracy and political institutions for growth. He found that growth results from maintenance of the rule of law, low government consumption, free-markets structure and improved human capital. There has also been research on the relation between economic freedom and economic growth.

Economic theory indicates that economic freedom affects incentives, productive effort, and the effectiveness of resource use. Using cross-section data analysis in 98 low-, middle-, and high-income countries, Islam (1996) indicated that economic freedom has a direct relation with per capita income and economic growth rate. Similarly, Gwartney (2009) shows that economic freedom exerts positive effects on economic growth and per capital income. On the other hand Sala-i-Martin et al, (2004), using a novel Bayesian approach in 88 countries over 1960-1996 to study the growth determinants, found that the degree of capitalism, political rights and the socialism dummy are not strongly growth correlated.

In some researches, the relation between FDI and economic freedom has been considered. In these researches, the economists try to answer to this question that, do foreign investors give a reward to countries with higher levels of economic



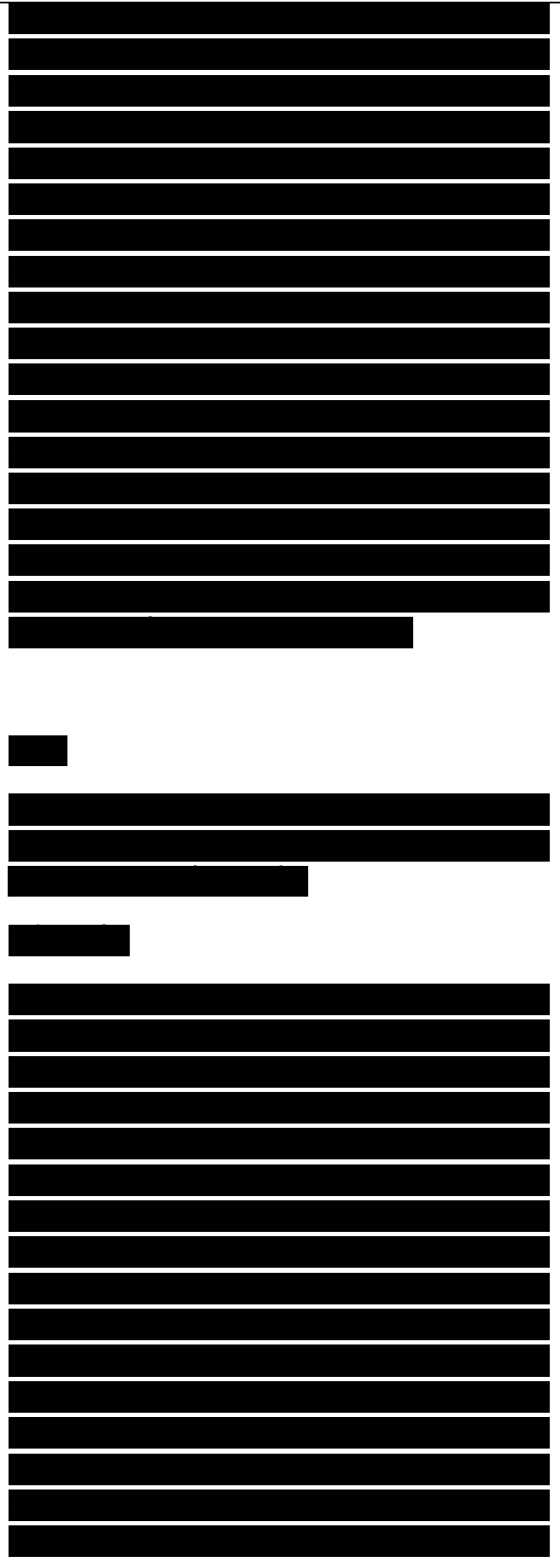
freedom by expanding flows of foreign investment to them? Contrary to the studies that claimed FDI has frequently found an insignificant coefficient on the economic freedom variable, Wheeler and Mody (1992), Kapuria (2007) for a sample of developing countries, focus on the extent of economic freedom from intervention with the market mechanism, including the risk of expropriation, the freedom to engage in economic activity and the predictability of rules and their enforcement and also their impact on FDI. Their results have shown that Foreign Direct Investment positively relates with increases in certain components of economic freedom. Similarly, Bengoa and Sanchez-Robles (2003) found economic freedom as a positive determinant of FDI in 18 Latin American countries.

Bài 5

HUMAN CAPITAL FORMATION AND FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

SUMMARY

This paper synthesises the existing literature on human capital formation and foreign direct investment (FDI) in developing countries. The aim is to take a bird's eye view of the complex linkages between the activities of multinational enterprises (MNEs) and policies of host developing countries. In doing so, general trends, best practices and policy experiences are extracted to evaluate the current state of knowledge. The literature indicates that a high level of human capital is no doubt one of the key ingredients for attracting FDI, as well as for host countries to gain maximum benefits from their activities. Most developing countries, however, underinvest in human capital, and the investment that is actually taking place is unevenly distributed across countries and regions that have adopted different human resource development

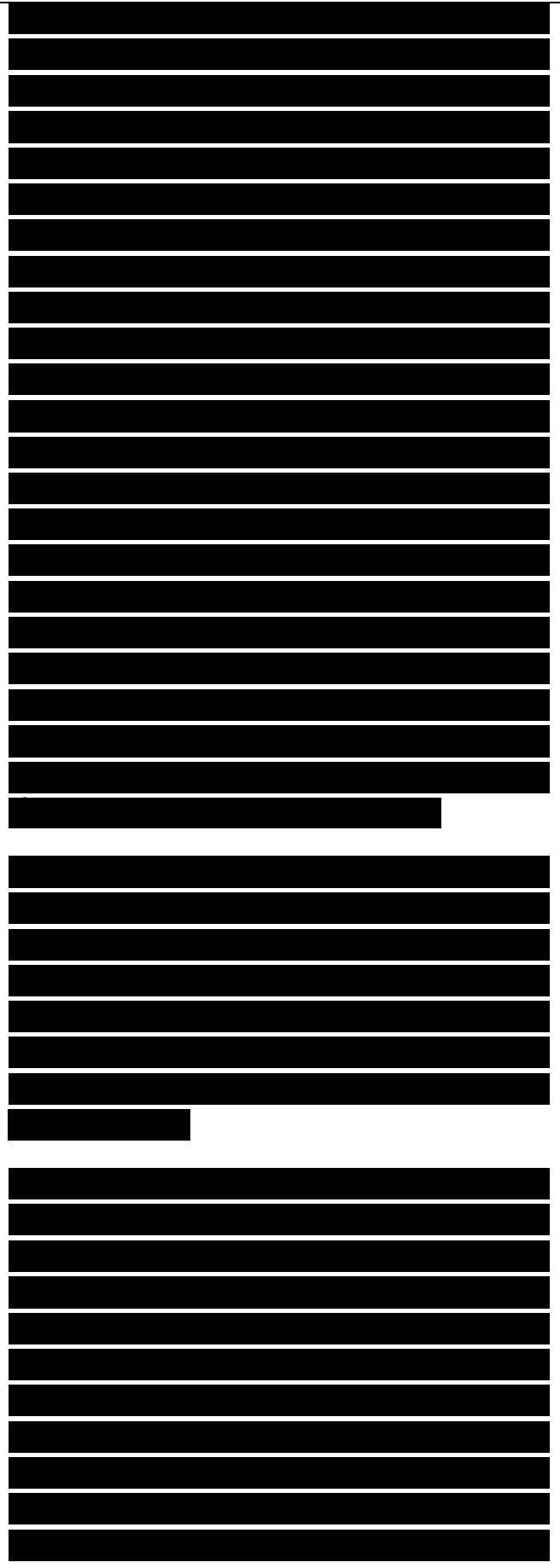


(HRD) policies. To improve human capital formation and thus to attract more FDI would therefore require a more coherent approach that takes host country constraints such as limited budgetary resources into account. One such approach is to provide strong incentives for MNEs and Investment Promotion Agencies (IPAs) to participate in formal education and vocational training even for workers employed by domestic firms. This allows HRD to be flexible and demand-driven. Another policy option is to facilitate HRD for small- and medium-sized domestic enterprises which usually do not invest sufficiently in training of employees although these enterprises stand to gain most from education and training.

In addition, FDI promotion policies can target high value-added MNEs that are more likely to bring new skills and knowledge to the economy that can be tapped by domestic enterprises.

Lastly, it is important that key components of HRD policies, i.e. formal schooling and vocational education and training policies (post-formal schooling) are well co-ordinated so as to equip students with knowledge and skills that will later be complimentary to training opportunities provided in the labour market.

The objective of this paper is to delve into the vast literature of HRD and FDI in order to identify how this virtuous circle takes place and to seek ways to fine-tune policies to promote it. In doing so, empirical regularities, best practices and numerous policy experiences are extracted from the literature. Surprisingly, there has been a lack of comprehensive survey done on this issue as yet in spite of the growing concern and interest on this issue by policy makers, academics and other stakeholders. Since the major aim of this paper is to capture common regularities in how host developing countries



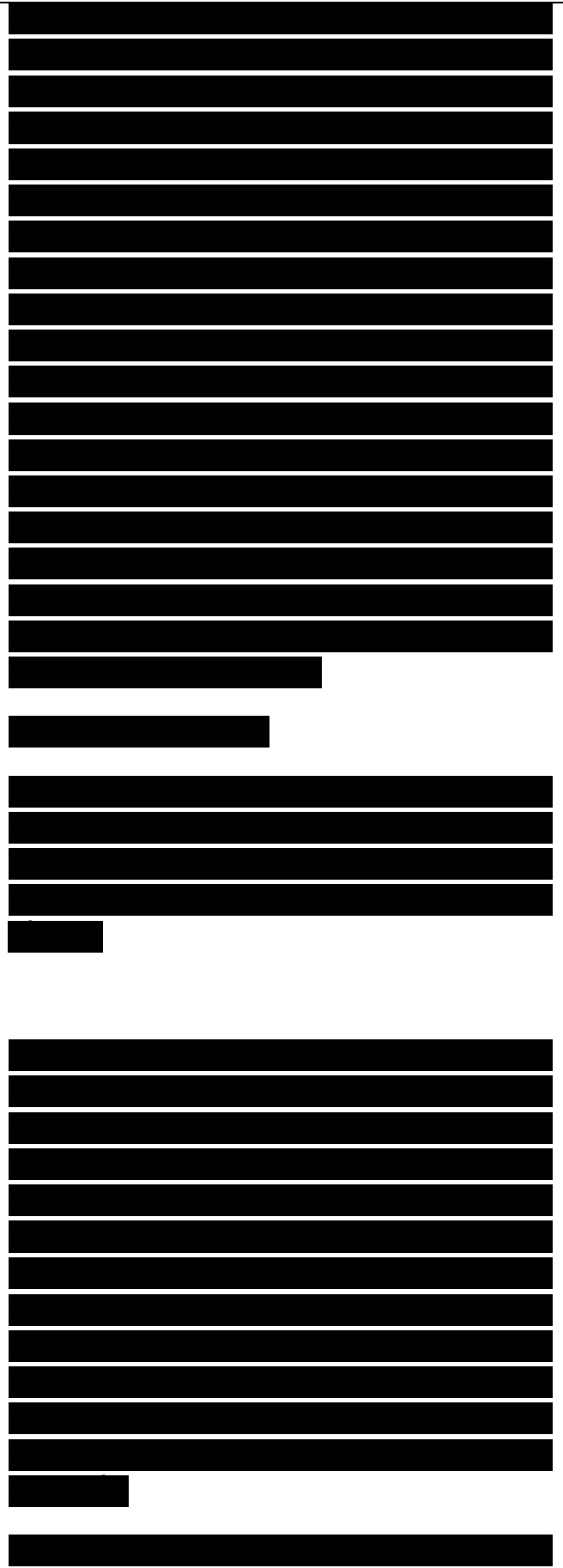
mobilise human resources, it will not cover the whole literature exhaustively. The paper is organised as follows. The rest of this section summarises questions to be posed throughout the paper. Section II presents background of the issue by summarising recent trends in FDI and HRD in developing countries. The next three sections provide the meat of the paper including: *i)* attracting inward FDI; *ii)* human capital formation by MNEs and technology transfers; and *iii)* the virtuous circle of human capital formation, incoming FDI, and technology transfers. Section VI concludes by revisiting the posed questions and providing directions for future research.

Questions Posed

The following lists key policy questions on HRD and FDI to be tackled throughout the paper. All the questions will be reviewed and assessed in the concluding chapter.

Question 1: What are the level and type of human capital necessary for host developing countries to attract FDI? It is often argued that MNEs determine the choice of location based on the availability of high level of human capital. What exactly is the level of human capital (education and skills) that the MNEs are seeking? Do different types of MNEs seek different sets of skills, or are there minimal levels of human capital commonly acknowledged without which it is difficult to attract even the least skill-intensive MNEs?

Question 2: What are MNEs and domestic firms doing in terms of human capital formation?

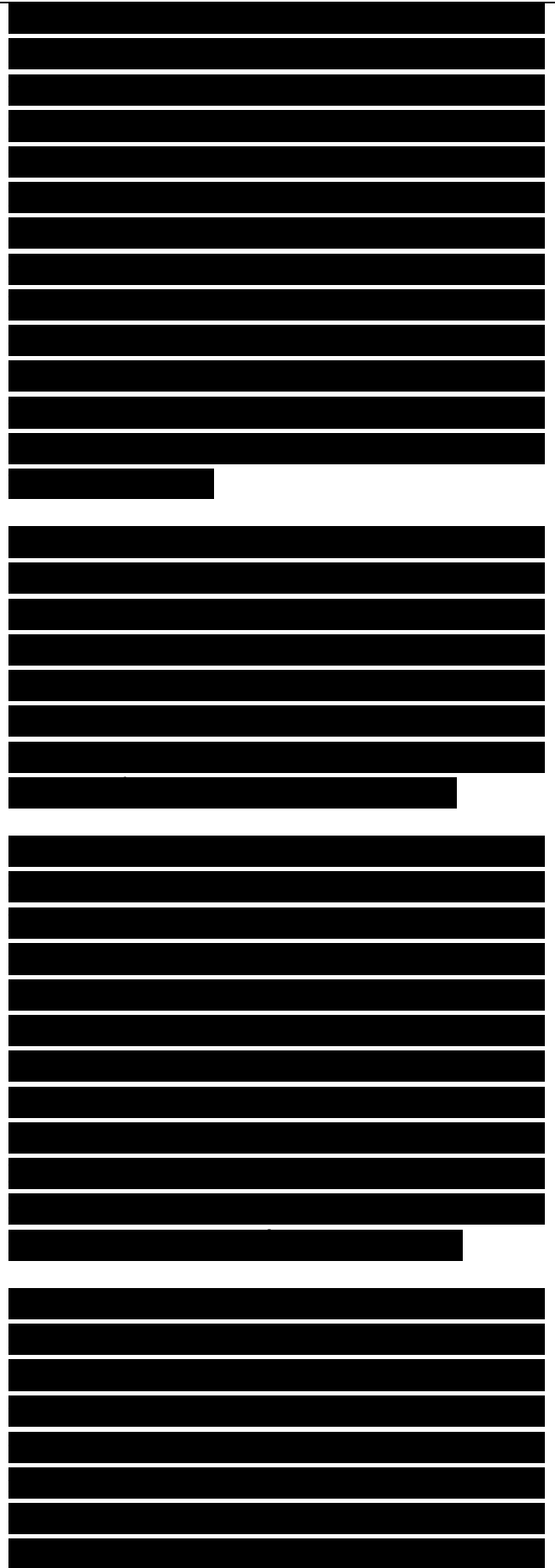


What are the correlates and determinants of training activities? After host countries successfully attract FDI, the next step is to have MNEs participate in improving the level of human capital of their workers as well as employees in other domestic firms. Case studies and firm surveys can be used to address: *i*) incidence, intensity, and the type of training activities performed by MNEs and domestic firms; *ii*) beneficiaries of training; *iii*) source of finance for training; and *iv*) the type of MNEs that are more likely to train?

Question 3: How does human capital formation of MNEs contribute to technology transfers? One of the key motivations for the host countries to attract MNEs is to enjoy technology transfers. Is there any strong evidence of technology transfers in developing countries? What are the underlying conditions for such transfers to occur?

Question 4: What has been the role of government policies within the linkages between human capital formation and FDI? What are the good practices? What are the tentative policy conclusions? After clarifying all the information surrounding the linkage between FDI and human capital formation, we address the most important question in this paper: which policies work and which do not? In doing so, past policy attempts will be assessed to identify tentative policy conclusions.

Question 5: Is there any evidence of a virtuous circle of human capital formation and increased inflow of MNEs? What is the role of policy to facilitate the virtuous circle? Perhaps the ultimate scenario for the host country is to attain the virtuous circle where improvements in the level of human capital lead to more incoming MNEs, and improved training and technology spillovers from MNEs lead to a further increase in the human capital which leads to more



incoming MNEs. Although it may be too early to assess the extent/mechanism for this circle to occur, we gather all possible evidence to identify the underlying conditions.

Bài 6

Investigating the relationship of inward foreign direct investment and poverty in developing countries

2. LITERATURE REVIEW

In this section of the study, literature concerning Foreign Direct Investment, economic growth and poverty will be discussed. The literature review consists of key articles from these areas of study. Because of the vastness of the subjects in question, the literature review is only comprised from literature which is closely linked to the research questions. First, literature will be reviewed concerning FDI and the possible connection it has with economic growth in developing countries. Second, the linkage between economic growth and poverty reduction will be examined. Third, the discussion will move on to pro-poor growth, which will be preceded by poverty and how it is measured. Finally, the theoretical framework of the thesis will be presented.

2.1 Foreign Direct Investment

Foreign Direct Investment refers to investments, which are meant to be lasting and are directed to

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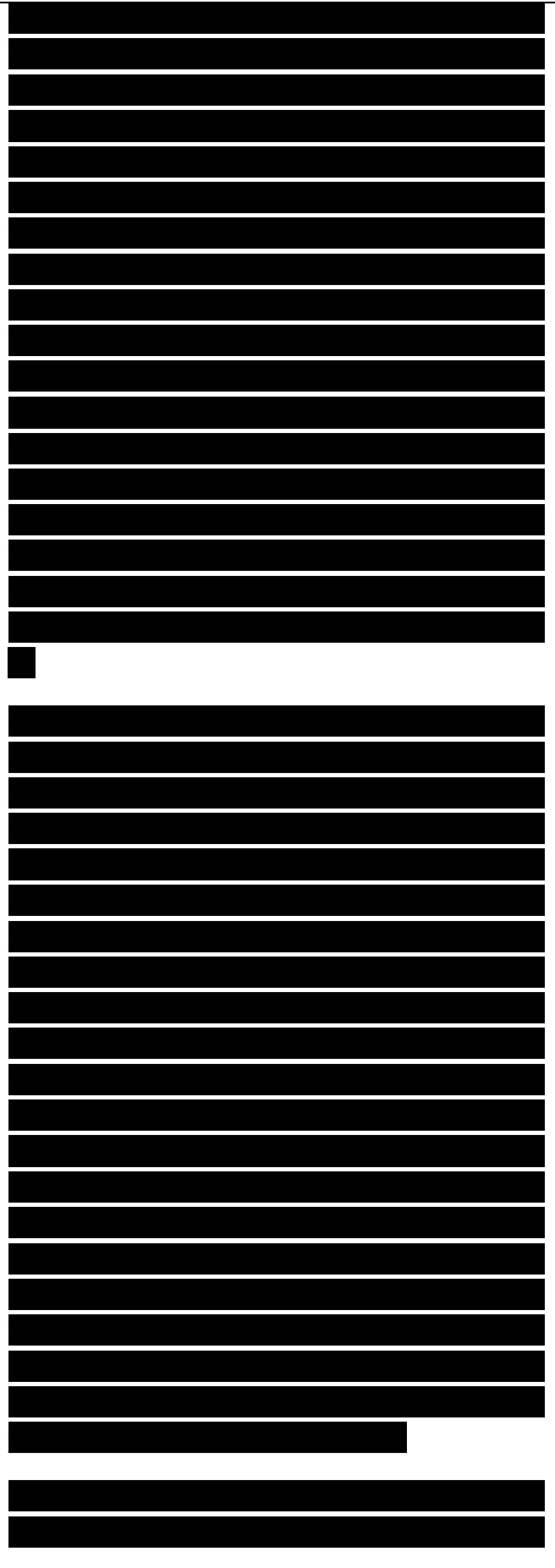
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enterprises located outside the economy of the investor. They usually include such investment types as wholly owned subsidiaries, joint ventures and mergers and acquisitions. FDI comprises of three different components equity capital, reinvested earnings and other capital, which mainly consists of intra-company loans. (UNCTAD, 2002) According to the Organization for Economic Co-operation and Development (OECD, 1996) description of FDI, the foreign investor must own at least 10% of ordinary shares or voting power of an enterprise, with a few exceptions. The investor has to own more than 10%, if it does not have an effective voice in management, and on the contrary, the investor can also own less, if still maintaining an effective voice in management. This is what separates Foreign Direct Investment from for example Foreign Portfolio Investment. In the case of FDI, the investor has intentions to exercise control over the enterprise. A broader definition of FDI was made by Dunning (2001), who stated that on top of financial assets, FDI also refers to intellectual capital and transfer of technology. Thus including technology, knowledge, capital and financial assets, which are all moved abroad. Alfaro et al. (2009) add that FDI can also foster linkages to local firms. These linkages can be very beneficial to the host economy, if the country in question is able to take advantage of them. There are several suggested ways in which FDI affects host economies. For example, Dunning (1993) describes that FDI inflows can create employment opportunities in host countries, which can increase income for locals and improve the standard of living.

Zhang suggests (2001a, 2001b) that inward FDI may enhance capital formation and bring special resources to host nations. These resources can be management know-how, established brand



names, technology transfer and spillover effects. There has been some debate whether beneficial spillover effects do occur outside theoretical formulations. Görg& Greenaway (2004) conclude that empirical evidence about the benefits spillovers can be hard to find, but this might be due to concentration on wrong types of studies. Giroud and Scott-Kennel (2006) also note that studies on spillovers provide inconclusive results and there should be an emphasis in the future to study mechanisms by which spillovers occur.

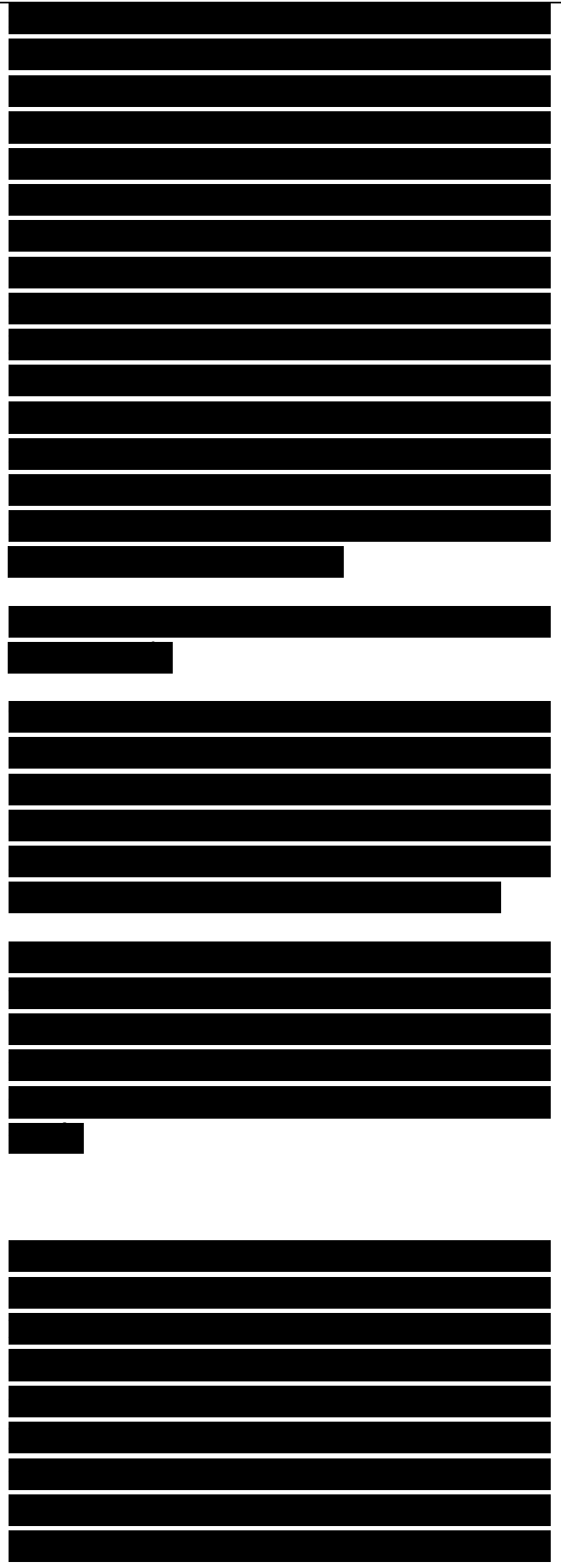
2.1.1 FDI and economic growth in developing countries

According to many researchers, FDI inflows are seen as the main factor for economic growth in developing countries. This is stated at least in studies by Abdul Karim&Ahmad (2009), Klein & al. (2001), Görg& Greenaway (2004) and Zhang (2006).

Correspondingly many researchers see economic growth as the main driver for poverty reduction. This linkage will be discussed more thoroughly in the next subchapter, and a more comprehensive description of the whole process is given in chapter 2.4 the theoretical framework.

These abovementioned researchers also acknowledge that there are other factors contributing to economic growth, but nevertheless they consider FDI being one of the most important ones. This is agreed also by Jalilian& Weiss (2002), who state in their research of countries from the Association of Southeast Asian Nations (ASEAN), that in this region FDI flows were associated with higher rates of economic growth.

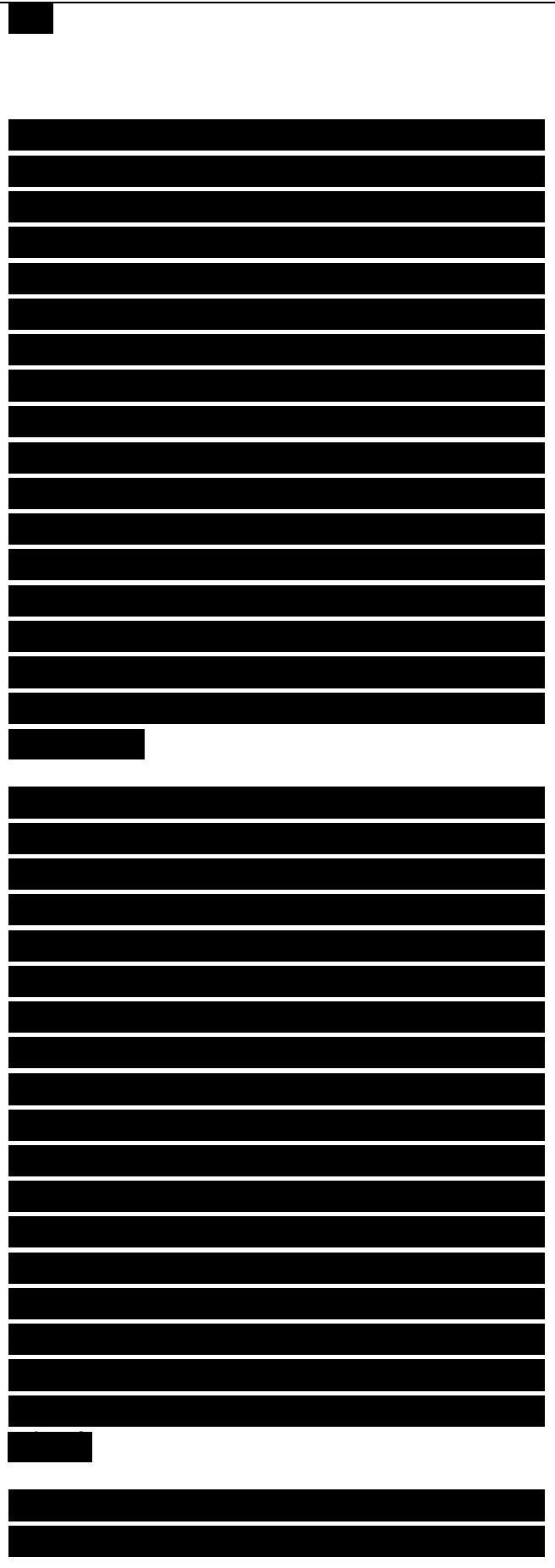
However, it has to be noted that they do not



claim a causal relationship, just that higher FDI inflows were associated with higher rates of economic growth. Abdul Karim&Ahmad (2009) share this view and also suggest in a more normative manner, that economies in the ASEAN area should try to increase the amount of inward FDI, in order sustain their path of economic growth. In many of these aforementioned studies, there is lack of deeper discussion on how the particular study defines poverty, or how has it ended up using the poverty measures it is using. As will be shown later in this study, poverty can be defined and measured in many different ways, thus it should be explained why the researchers have chosen these poverty measures.

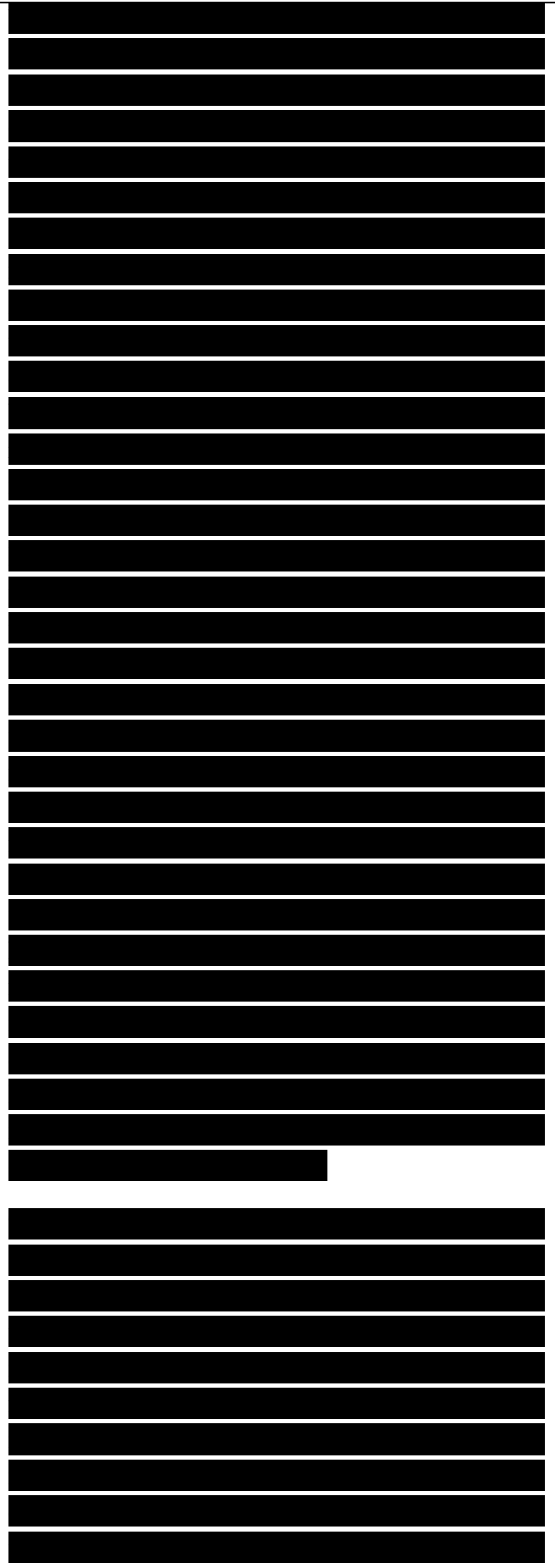
There are also researchers who argue that the relationship between FDI and economic growth is not as universal and clear cut as it would seem. Blomström et al. (1994) find in their study of 78 countries, that poorer countries do not enjoy as much growth benefits from FDI as richer countries. According to De Mello (1999), the impact that FDI has on growth is dependent on the technological gap that is between what he calls leaders (nước dẫn đầu công nghệ) and followers (nước tiếp thu công nghệ). For the technological leaders, the substitutability of technology is easier than for the followers. Thus for the followers FDI may not be as important for cross-border knowledge transfers as previously thought. De Mello considers that this may be due to country specific factors, such as political risk, trade regimes and institutions.

In their study on the growth effects of FDI, Borensztein et al. (1998) state that FDI is an important vehicle for technological transfer from developed countries to developing countries. However, the effect of FDI on technology transfer and on economic growth depends on the human capital available in the host country. They



suggest that the size of the educated workforce has to be over a given threshold before efficient technology transfer can occur and FDI have a greater growth effects than domestic capital. This is backed by similar results found by Wijeweera et al. (2010). They conclude that a nation cannot absorb new technology if they do not have adequate levels of educated and skilled workforce. They also note that FDI itself does not create efficiency gains and merely increasing the amount of FDI a country cannot increase its efficiency. Wijeweera et al. (2010) also suggest that FDI is an engine of growth for developing countries, but that long-term benefits can be better realized if the host country is an open economy with high levels of trade liberalization. Basu et al. (2003), in their study of 23 developing countries and the connection between FDI, GDP and the liberalization level, come to similar conclusions. They found in their research, that long term foreign capital did not reach closed economies until they had attained some levels of economic growth. Basu et al. (2003) add that trade and financial restrictions do hinder the inflow of foreign capital.

In the aforementioned study of Wijeweera et al. (2010), they also propose that a high level of corruption has a negative impact on economic growth. However, according to Al-Sadig (2009), while corruption can discourage foreign investors from investing to a certain country, foreign investors seemed to value the institutional quality of the country more than the corruption level. The author stresses however, that this should not be taken as an indication that corruption is not an important factor for foreign investors, but rather that the quality of institutions is. It has to be noted, that accurately estimating corruption levels in a given country is very difficult, hence they should always be

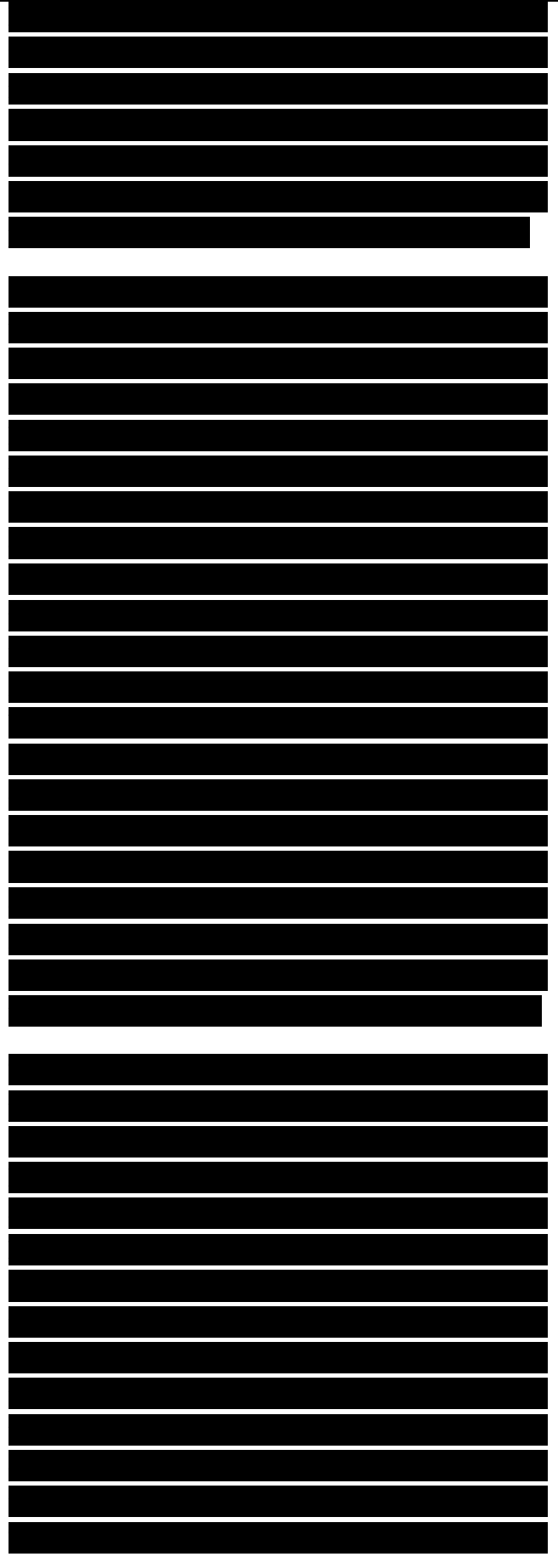


studied with at least some level of scepticism.

In examining financial markets and economic growth, Alfaro et al. (2004), also suggest that FDI has an important role in enabling economic growth. However, they also point out that the development level of the local financial market plays a big role in the fact, can the country realize the positive effects. Along similar lines, Alfaro & Charlton (2007) propose that certain quality factors of FDI increase it's effect on economic growth. In the study, they look at quality between different sectors and differentiate FDI according to the average skill intensity and reliance on external capital of the sector in question. However, they add that such a quality unit is hard to create and effectively use in calculations. Hence, the quality unit is a sum of many country and project characteristics, which makes every case unique and thus impossible to duplicate.

In their study of developing countries, Herzer et al. (2007), challenge the widespread belief of FDI contributing to economic growth. They claim that in the vast majority of developing countries FDI does not have a long or a short-term effect on economic growth. They also point out, that there are weaknesses in the empirical literature about the growth inducing effects of FDI. They do not believe that the positive connection between FDI and economic growth is as clear as generally believed. Firstly, they argue that this is due to FDI's share of GDP being too small to have a significant growth effect. Secondly, there are many growth-limiting effects of FDI, which vary from country to country.

As shown in this chapter, there is a lot of variation between researchers about the effects



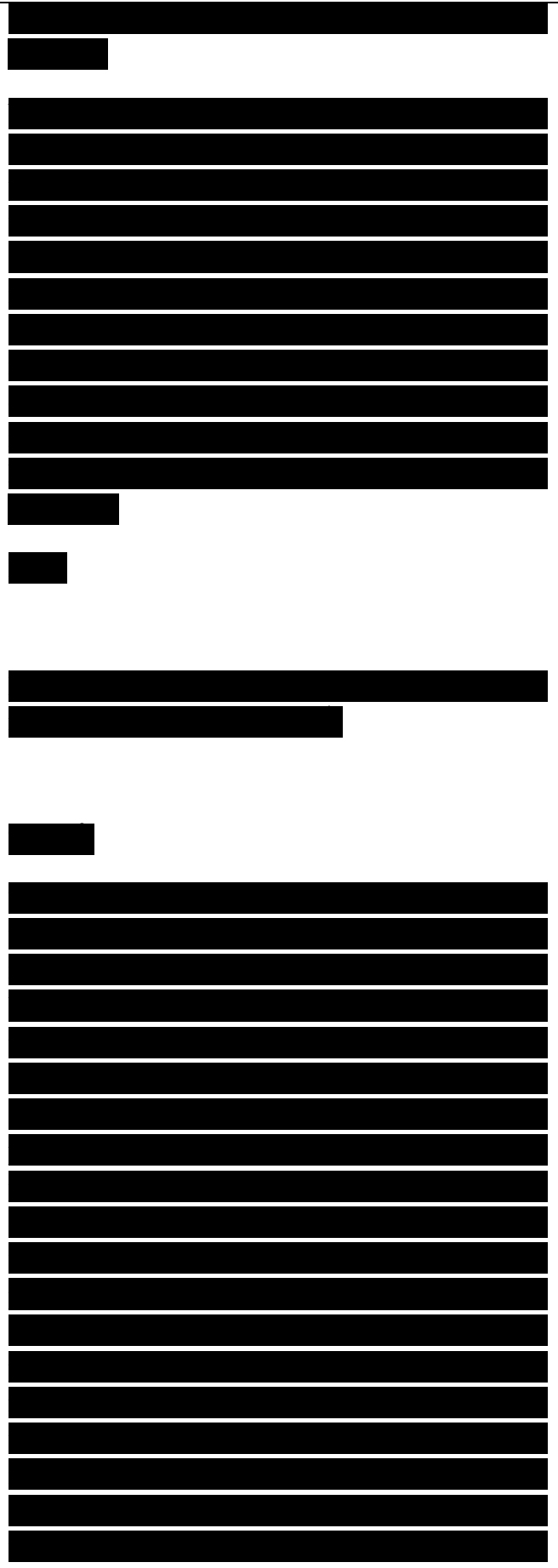
of FDI on economic growth. They vary from FDI being the most important factor, to FDI not having an effect at all. However, most researchers declare that there is a positive connection between FDI and economic growth, but there are other factors which determine how the positive effects can be realized. The next subchapter will examine literature concerning the linkage between economic growth and poverty reduction in developing countries

Bài 7

Openness, economic growth, and human development: The Asian experience

Abstract

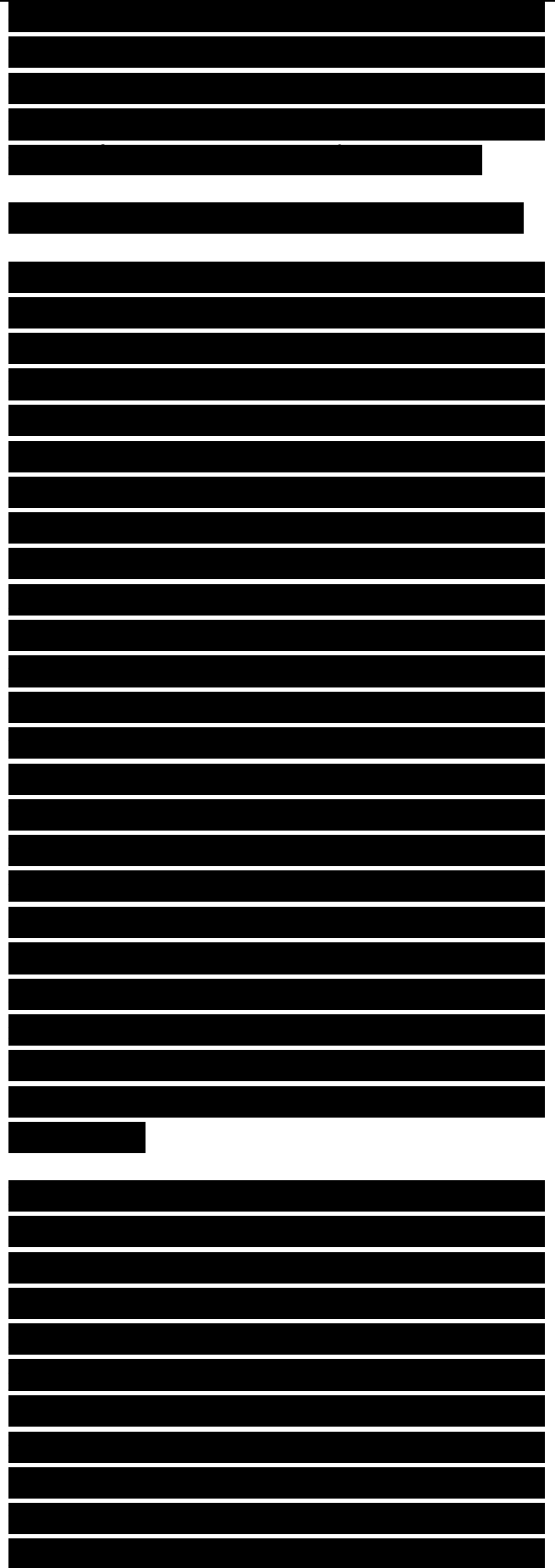
While policy makers and international development organisations emphasise the role of openness to trade in achieving sustained economic growth, the interdependence of openness, economic growth, and human development is not well studied. We empirically examine this interdependence through a simultaneous equations system which we estimate by three-stage least squares. The results suggest that in Asia (i) openness has a strong positive impact on both economic growth and human development; (ii) human capital and FDI have a strong positive effect on both economic growth and human development; (iii) while human development contributes positively to growth, growth has a negative and significant influence on human development. Our findings confirm the success of trade liberalisation policies in the region in achieving higher growth but also suggest that this has had negative impact on human development. Consequently there may be a role for distributional policies that would improve income distribution and ultimately human development.



2.2 Economic growth and human development

Given the search for a better measure of economic progress and social welfare, due to recent criticism of GDP as an indicator of economic performance (Fleurbaey, 2009), we favour the HDI index as an indicator of human development.² Although, the HDI index has received severe criticism (see Klugman et al., 2011; Srinivasan, 1994), after reviewing the available indicators of development beyond GDP, Fleurbaey (op cit) concludes that it is a real improvement and a prominent indicator of human development due to its simplicity and generalisability. The human development approach takes its inspiration from the human capabilities approach proposed by Sen (1985, 1999). This approach was further developed by Nussbaum (2000) and Robeyns (2005). Since the publication of human development reports (HDRs) in 1990s, human development has emerged as the ultimate objective of economic policy by replacing narrowly defined economic growth. Human development is a broad development paradigm which concentrates on enlarging the human capabilities in order to enable individuals to live long and healthy lives (Anand and Sen, 2000a).

Generally, economists expect a positive association between economic growth and human development, however, this connection is not automatic.³ Evidently the strength of the impact of economic growth on human development depends upon a variety of factors, such as economic structures, income and asset distribution, institutional quality, and policy choices many or all of which vary across countries (see Acemoglu and Robinson, 2013). Standard World Bank policies and international business community emphasise the need to achieve higher growth which they believe is always pro-poor. However, White and Anderson (2001) provide evidence of a trade off between growth and distribution. The authors conclude that poor developing countries should concentrate on distribution rather than growth.



Nevertheless, a stronger relation between economic growth and human development does appear to exist in economies with lower levels of poverty, fairer distribution of income, and higher spending on education and social development. Economic growth contributes to human development through household and government expenditures. The consequent improvement in the quality of the labour force in health, nutrition and education enhances their capabilities and productivity, and in turn, contributes to growth (Ranis and Stewart, 2000). In this view, human development contributes to future economic growth rather than being only an end-product. Ranis and Stewart (2000) and Suri et al. (2011) provide empirical evidence of a two-way causation between economic growth and human development with human development being more important to sustain growth

